(13)

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Title: Keyton E. Barker and Pauline Barker, et al., Petitioners
v.
Kansas, et al.

Docketed:
October 10, 1991

Court: Supreme Court of Kansas

Counsel for petitioner: Fowler,Kevin M.

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Entry	Date	Note	Proceedings and Orders
1	Oct 10 1991	G	Petition for writ of certiorari filed.
2	Nov 8 1991	G	Motion of Retired Officers Association for leave to file a brief as amicus curiae filed.
5	Nov 8 1991		Brief of respondents Kansas, et al. in opposition filed.
4	Nov 12 1991	X	Brief amicus curiae of United States filed.
3	Nov 13 1991		DISTRIBUTED. November 27, 1991
6	Nov 27 1991		Motion of Retired Officers Association for leave to file a brief as amicus curiae GRANTED.
7	Nov 27 1991		Petition GRANTED.
			**********
8	Jan 2 1992		SET FOR ARGUMENT TUESDAY, MARCH 3, 1992. (2ND CASE)
9	Jan 10 1992		Joint appendix filed.
10	Jan 10 1992		Brief of petitioners Keyton E. Barker, et al. filed.
11	Jan 10 1992		Brief amicus curiae of The Retired Officers Association filed.
12	Jan 13 1992		Brief amicus curiae of United States filed.
13	Jan 14 1992	G	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
16	Jan 21 1992		Record filed.
		*	Certified record and proceedings Supreme Court of Kansas. (1 Box)
14	Jan 27 1992		Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
15	Jan 28 1992		CIRCULATED.
17	Feb 12 1992	X	Brief amici curiae of Natl. Conference of State Legislatures, et al. filed.
19	Feb 12 1992	X	Brief amici curiae of Arizona, et al. filed.
18	Feb 13 1992	X	Brief of respondents Kansas, et al. filed.
20	Feb 25 1992	X	Reply brief of petitioners Keyton E. Barker, et al. filed.
21	Mar 3 1992		ARGUED.

No. 91-611

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1991

KEYTON E. BARKER and
PAULINE BARKER, et al.,

Petitioners,

vs.

STATE OF KANSAS; KANSAS DEPARTMENT OF REVENUE; SECRETARY OF REVENUE OF THE STATE OF KANSAS; and DIRECTOR OF TAXATION OF THE STATE OF KANSAS,

Respondents.

Petition For Writ Of Certiorari To The Supreme Court Of The State Of Kansas

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

WHETHER THE KANSAS INCOME TAX ACT VIOLATES CONSTITUTIONAL OR STATUTORY PRINCIPLES OF INTERGOVERNMENTAL TAX IMMUNITY, AS RECENTLY APPLIED IN *DAVIS v. MICHIGAN DEPT. OF TREASURY*, 489 U.S. 803 (1989), BY FAVORING RETIRED STATE AND LOCAL EMPLOYEES OVER RETIRED MEMBERS OF THE UNITED STATES ARMED FORCES.

PARTIES TO THE PROCEEDING

The parties to the proceeding in the Kansas Supreme Court were: (1) Petitioners Keyton Barker and Pauline Barker; William Richards, Sr. and Ollun E. Richards; Andrew J. Peele; Clarence Wolf and Flora B. Wolf; John G. Fowler and Carol B. Fowler; Leonard W. Williams and Loneta S. Williams; Anthony E. Corcoran; William J. Lober, Jr. and Marjorie E. Lober; Roger W. Clay and Betty J. Clay; Roger J. Olson and Nancy W. Olson; Leland W. Keister, Jr. and Patricia K. Keister; and Edward F. Kellogg and Renata O. Kellogg, for themselves and all others similarly situated;* and (2) Respondents State of Kansas; Kansas Department of Revenue; Secretary of Revenue of the State of Kansas; and Director of Taxation of the State of Kansas.

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* Petitioners and their counsel were designated by the district court to represent a certified plaintiff class which consists of approximately 14,000 federal military retirees [and, where applicable, their joint taxpayer spouses] who have been subject to Kansas state income taxation during one or more tax years from 1984 through 1989. *See* Record at 781-782, 784-785 and 1990, *Barker* (Dist. Ct. Case No. 89-CV-666). Petitioners were Appellants in the proceedings before the Kansas Supreme Court.

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No. _____

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Petition For Writ Of Certiorari To The Supreme Court Of The State Of Kansas

PETITION FOR WRIT OF CERTIORARI

Petitioners, on behalf of themselves and all others similarly situated, respectfully petition this Court for a writ of certiorari to the Supreme Court of the State of Kansas.

OPINIONS DELIVERED BELOW

The opinion of the Kansas Supreme Court [App. A, *infra* at 1a-35a] is reported at 249 Kan. 186, ___ P.2d ___ (1991). The Memorandum Decision and Order of the District Court of Shawnee County, Kansas [App. B, *infra* at 36a-46a] is unreported.

JURISDICTION

Petitioners seek review of a judgment entered by the Kansas Supreme Court on July 12, 1991 upholding the constitutionality of the Kansas Income Tax Act. App. A at 3a. This petition is filed within the 90-day period allowed by law and 28 U.S.C. § 1257(a) confers jurisdiction to review the judgment in question by writ of certiorari.

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED

The Supremacy Clause of the United States Constitution, Article VI, cl. 2 provides in pertinent part:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

4 U.S.C. § 111 provides in pertinent part:

> The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States . . . by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate

against the officer or employee because of the source of the pay or compensation.

In accordance with Sup. Ct. R. 14.1(f), the text of pertinent Kansas statutes and regulations is set forth in Appendix C, *infra* at 47a-60a.

STATEMENT OF THE CASE

On April 17, 1989, two class actions were filed in Kansas state court challenging the constitutionality of the Kansas Income Tax Act [Kan.Stat.Ann. § 79-3201 *et seq.* ("KITA")] under constitutional and statutory principles of intergovernmental tax immunity.[1] Record at 11-20, *Barker* (Dist. Ct. No. 89-CV-666); Record at 39-42, *Lober* (Dist. Ct. No. 89-CV-1100). These lawsuits were subsequently consolidated in the District Court of Shawnee County, Kansas and certified as a class action. Record at 783-85, *Barker* (Dist. Ct. No. 89-CV-666).[2]

Petitioners are retired members of the United States Armed Forces [and their joint taxpayer spouses] who have been and remain subject to Kansas income taxation of their federal military retired pay. They are also designated as representatives of a plaintiff class which consists of approximately 14,000 federal military retirees [and

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[1] In *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (Mar. 28, 1989), this Court held that state income tax schemes which favor retired state and local employees over retired federal employees violate the constitutional doctrine of intergovernmental tax immunity and 4 U.S.C. § 111. *Id.* at 817.

[2] Under local practice, *Barker* became the lead case following consolidation. Therefore, all further citations to the record of proceedings below shall rely upon the *Barker* Record [hereinafter "R"].

their joint taxpayer spouses] subject to such taxation during one or more tax years from 1984 through 1989. R at 784; App. A at 6a. Because the retirement pay of all State and local government retirees is exempt from Kansas taxation under a statutory scheme which grants exemptions based upon the source of retirement compensation, Petitioners alleged that KITA's discriminatory exemption scheme violates federal principles of intergovernmental tax immunity by favoring retired state and local employees over retired members of the United States Armed Forces. R at 11-20, 21-30 and 310-325. Petitioners further alleged that all members of the plaintiff class are entitled to appropriate relief from such unconstitutional taxation in accordance with *Davis v. Michigan Dept. of Treasury, supra. Id.*

On February 23, 1990, Petitioners moved for summary judgment, contending in relevant part that KITA unconstitutionally discriminates against federal military retirees under principles of intergovernmental tax immunity, and 4 U.S.C. § 111 and the Supremacy Clause of the United States Constitution. R at 1003-10 and 1359-60. In opposition to this dispositive motion, Respondents argued that differential taxation of military retired pay under KITA is constitutional because it is directly related to and justified by substantial differences between the classes of retirees. R at 1437-68.

On October 31, 1990, the district court concluded that "there are substantial differences between the two classes which justifies the disparate tax treatment" of military retired pay under KITA. App. B at 43a. Because military retirees "are subject to recall" to active duty; military retirees "do not contribute to their retired pay"; and this Court has characterized military retired pay as "reduced

compensation for reduced current service," the district court held that "the Kansas Income Tax Act is not unconstitutional nor in violation of 4 U.S.C. § 111." App. B at 44a-45a. Petitioners' motion for summary judgment was accordingly denied, and the district court entered judgment *sua sponte* in favor of Respondents. App. B at 46a. Petitioners appealed. R at 2001-03.[3]

In a published decision filed July 12, 1991, the Kansas Supreme Court affirmed the district court's judgment and held that KITA is constitutional on the basis that differential taxation of military retirement benefits "is directly related to and justified by significant differences between the two classes of retirees." App. A at la and 3a. In support of its decision, the Kansas Supreme Court relied upon a "presumption of constitutionality" [App. A at 9a], "federal cases holding that military retirement pay is reduced compensation for reduced current services" [*Id.* at 30a], and the "noncontributory" nature of the military retirement system [*Id.* at 26a] to conclude that KITA satisfies the requirements of *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989). App. A at 1a, Syl. ¶ 2.

REASONS FOR ALLOWING THE WRIT

This case presents an important and recurring federal question with far-reaching impact: whether state income tax schemes that favor retired state and local government

[3] This case was later transferred from the Kansas Court of Appeals to the Kansas Supreme Court under the provisions of Kan. Stat. Ann. § 20-3017. App. A at 5a; *see also* Kansas Supreme Court Order (filed Nov. 19, 1990).

employees over federal military retirees violate the doctrine of intergovernmental tax immunity and 4 U.S.C. § 111. State courts of last resort have delivered conflicting opinions on this issue and further divergence is inevitable. Therefore, review on writ of certiorari is necessary to resolve existing conflict among the states and to ensure national uniformity in federal law. Such review is also necessary to enforce controlling principles of intergovernmental tax immunity.

I. THE FEDERAL QUESTION PRESENTED SHOULD BE RESOLVED BY THIS COURT TO PROVIDE AUTHORITATIVE GUIDANCE TO ALL STATES OF THE UNION

A. The Opinion Below Directly Conflicts With Decisions of Other State Courts of Last Resort.

The holding in this case that military retirees are not entitled to the same state income tax treatment as federal civil service retirees and state and local government retirees under *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989), directly conflicts with applicable decisions of the Colorado Supreme Court, Arkansas Supreme Court and Missouri Supreme Court. *See Kuhn v. State of Colorado*, ___ Colo. ___, ___ P.2d ___ (Nos. 90-SA-299 and 90-SA-300, filed Sept. 16, 1991) (*en banc*) [WESTLAW, 1991 WL 179971]; *Pledger v. Bosnick*, 306 Ark. 45, 811 S.W.2d 286 (June 10, 1991), *petition for cert. filed*, 60 U.S.L.W. 3173 (U.S., Sept. 3, 1991) (No. 91-375); and *Hackman v. Director of Revenue*, 771 P.2d 77 (Mo. 1989) (*en banc*), *cert. denied*, 110 S.Ct. 718 (1990). Relying upon controlling principles of federal law applied by this Court in *Davis*, the state courts of last resort in *Kuhn*, *Pledger* and *Hackman* each invalidated state income tax schemes which favored state

and local government retirees over federal military retirees.

The opinion below acknowledged the reasoning of *Pledger* and *Hackman* that "civil service retirees and military retirees should be treated alike" under 4 U.S.C. § 111 and *Davis*, but it expressly refused to follow those decisions. App. A at 33a. The Kansas Supreme Court, therefore, knowingly created a conflict between state courts of last resort on this important federal question which invites review on writ of certiorari.

This divergence of opinion was recently sharpened in light of the Colorado Supreme Court's *Kuhn* decision, which held that the Colorado income tax scheme in existence before *Davis* unconstitutionally discriminated between federal military retirees under age fifty-five and all other retirees under age fifty-five based upon the source of their retirement pay. *Kuhn*, ___ Colo. ___, 1991 WL 179971 at *6-7. In *Kuhn* a unanimous Colorado Supreme Court rejected the holding and rationale of the Kansas Supreme Court below and concluded that the characterization of military retired pay in "[s]everal federal cases dealing with nontax issues" as "current pay for reduced current services" does not directly relate to nor justify discriminatory state taxation of military retirement income. *Kuhn*, ___ Colo. ___, at 1991 WL 179971 at *4-7 and *8 n. 6.

B. Review by This Court on Writ of Certiorari Is Necessary to Resolve Existing Conflict Among the States and to Avoid Further Conflicting Decisions.

In view of constraints upon the jurisdiction of federal courts imposed by the Eleventh Amendment, the Tax

Injunction Act [28 U.S.C. § 1341] and considerations of comity, constitutional challenges to state taxes must ordinarily be pursued through state courts. *See, e.g., Pennhurst State School & Hosp. v. Halderman*, 465 U.S. 89, 122 (1984); *Fair Assessment in Real Estate Ass'n v. McNary*, 454 U.S. 100, 116 (1981). Consequently, the writ of certiorari from this Court is the only generally available means to resolve decisional conflicts between state supreme courts in state tax cases involving federally-protected rights. Review on writ of certiorari is, therefore, essential to resolve the existing conflict among state courts of last resort, and to ensure that federal protection from discriminatory income taxation will not depend upon the state residence of military retirees. *See McKesson Corp. v. Florida Alcohol & Tobacco Div.*, 110 S.Ct. 2238, 2245 (1990) [securing "state-court compliance with and national uniformity of federal law" are proper objectives of review].

Authoritative guidance from the Court is also necessary to avoid further state conflicts regarding the state tax treatment of military retirees. This important federal question is currently pending at the state appellate level in *Harper v. Virginia Dept. of Taxation*, 241 Va. 232, 401 S.E.2d 868, *vacated and remanded*, ___ U.S. ___, 59 U.S.L.W. 3772 (1991), *on remand* (Nos. 900770 and 900792, Va., argued Sept. 17, 1991); *Bohn v. Waddell*, 164 Ariz. 74, 790 P.2d 772, 780 (T.C. 1990), *aff'd on reconsideration*, 82 Ariz. Adv. Rep. 52, 807 P.2d 1 (T.C. 1991), *appeal docketed*, No. 1 CA-TX 90-029 (Ariz. App. 1991); and *Marx v. Winstead*, No. 141,652 (Chanc. Ct. Hinds Cty., Miss., Feb. 7, 1991), *appeal docketed*, No. 91-CC-0475 (Miss. 1991). The issue has also been raised in similar litigation at the trial court

level in Georgia and Louisiana,[4] and it may eventually be reached in *Hogan v. Musolf*, 157 Wis.2d 362, 459 N.W.2d 865 (Wis.App. 1990), rev'd ___ Wis.2d ___, 471 N.W.2d 216 (Wis. 1991), *petition for cert. filed*, 60 U.S.L.W. 3173 (U.S., Sept. 5, 1991) (No. 91-380).

If the opinion below is not reviewed, other state courts might be inclined to uphold discriminatory taxation of military retired pay despite constitutional principles of intergovernmental tax immunity and 4 U.S.C. § 111. Likewise, state legislatures which currently afford military retirees the same tax treatment as other public sector retirees might be induced to impose discriminatory taxes against military retirees in an effort to alleviate fiscal woes.[5] The impact of such action would be felt by

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[4] *See Barto v. Collins*, No. D86354 (Super. Ct. Fulton Cty., Georgia) and *Krueger v. Collins*, No. D92445 (Super. Ct. Fulton Cty., Georgia); *Ponthier v. Broussard*, No. 344,035 (Dist. Ct., Parish of East Baton Rouge, La., Sept. 12, 1991) [refusing to follow the Kansas Supreme Court decision below and ruling that 4 U.S.C. § 111 "applies to federally derived compensation whether or not it is military or civil service"].

[5] After the announcement of *Davis*, at least 19 states passed remedial legislation to provide equal tax treatment for all federal retirees, including retired members of the United States Armed Forces. *See, e.g.*, Ala. Code § 40-18-20(d) (Supp. 1990); Ariz.Rev.Stat.Ann. § 43-1022(3) (Supp. 1990); Ark. Code Ann. §§ 26-51-306 and 26-51-307 (Michie Supp. 1991); Colo.Rev.Stat. § 39-22-104(f) (Supp. 1990); Ga. Code Ann. 48-7-27(a)(4) and (5) (Supp. 1991); Iowa Code Ann. 422.7.18 (West 1990); La.Rev.Stat.Ann. § 47:44.2 (West Supp. 1990); Mich.Stat.Ann. § 7.557(130) (e) and (f) (Callaghan Supp. 1990); Miss. Code Ann. § 27-7-15(k) and (1) (Law. Coop. Supp. 1990); Mo.Ann.Stat. § 143.124 (Vernon Supp. 1991); Mont. Code Ann. § 15-30-111(2)(c) (1991); N.M.Stat.Ann. § 10-11-135 (Repl. Pam.

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literally hundreds of thousands of retired military personnel who "earned" their entitlement to military retired pay through at least 20 years of honorable service to the United States. Since more than 1,179,000 "retired military annuitants" receive nondisability military retired pay of almost 20 billion dollars annually,[6] the potential nationwide impact of the Kansas Supreme Court's decision below is staggering.

II. THE DECISION BELOW CONFLICTS WITH CONTROLLING PRINCIPLES OF INTERGOVERNMENTAL TAX IMMUNITY RECENTLY REITERATED IN *DAVIS V. MICHIGAN DEPT. OF TREASURY*, 489 U.S. 803 (1989)

It is well settled that "a State may not single out those who deal with the [Federal] Government, in one capacity or another, for a tax burden not imposed on others similarly situated." *Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U.S. 376, 383 (1960). "[U]nder this test," it is first necessary to examine " 'the whole tax structure of the state' " in order "to determine how other taxpayers similarly situated are treated." *Id.* [quoting

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1990); N.Y. Tax Law § 612(c)(3) (McKinney 1991); N.C.Gen.Stat. § 135-9 (Supp. 1990); Okl.Stat.Ann. tit. 68 § 2358D(9) (West Supp. 1991); Ore.Rev.Stat.Ann. § 316.680(1)(c) (1990); Utah Code Ann. § 59-10-114(2)(d) and 3(a) (Supp. 1991); Va.Code Ann. § 58.1-322(C)(13) (Supp. 1991) [repealed 1990]; Wis.Stat.Ann. § 71.05(1)(a) (West Supp. 1990).

[6] *See* Department of Defense, SELECTED MANPOWER STATISTICS – Fiscal Year 1989, at 163 and 196 (1990); Department of Defense, ATLAS/DATA ABSTRACT FOR THE UNITED STATES AND SELECTED AREAS – Fiscal Year 1989, at 8 (1990).

Tradesmens Nat. Bank of Oklahoma City v. Oklahoma Tax Commission, 309 U.S. 560, 568 (1940)]. Once this examination is complete, the Court emphasized in *Davis* that " '[t]he imposition of a heavier tax burden on [those who deal with one sovereign] than is imposed on [those who deal with the other] must be justified by significant differences between the two classes.' " 489 U.S. at 815 [quoting *Phillips Chemical Co.*, 361 U.S. at 383]. In evaluating whether this "standard of justification" is satisfied, however, the relevant inquiry is whether "the inconsistent tax treatment is directly related to *and* justified by 'significant differences between the two classes.' " *Davis*, 489 U.S. at 816 [quoting *Phillips Chemical Co.*, 361 U.S. at 383-385 (emphasis added)].

In *Davis*, this Court struck down a differential exemption scheme under the Michigan Income Tax Act which "violate[d] principles of intergovernmental tax immunity by favoring retired state and local government employees over retired federal employees." 489 U.S. at 817. Given the statutory manner in which Michigan exempted retirement income by source of compensation, the retirement benefits of retired state and local government employees were exempt from state taxation while the benefits received by retired federal employees were not. *Id.* at 806 and n.2. However, Congress unmistakably forbids state taxation which discriminates against retired federal officers or employees "because of the source of the pay or compensation." 4 U.S.C. 111. *See Davis*, 489 U.S. at 812. Reasoning that Michigan's tax system "discriminate[d] on the basis of the source of [retirement] benefits," and that "[t]he State's interest in adopting the discriminatory tax" cannot justify differential treatment, the Court concluded that Michigan's exemption scheme

offended controlling precepts of federal law. *Davis*, 489 U.S. at 816-817. This analysis is equally applicable here.

A. All Government Retirees Are Similarly Situated For Purposes of Taxation and "Presumably Should be Taxed Alike."

Despite the importance of determining whether federal, state and local government retirees are "similarly situated" for tax purposes, the opinion below does not directly address or resolve this initial issue. Instead, the Kansas Supreme Court erroneously viewed the threshold question of whether the classes are "similarly situated" as synonymous with the ultimate question of whether differential taxation is justified by "significant differences" between the classes. *See, e.g.*, App. A at 15a-17a. This mistaken interpretation, however, directly conflicts with the analytical framework applied in *Phillips Chemical Co.*, 361 U.S. at 381-385, and it disregards the presumption of equal taxation applicable in cases involving intergovernmental tax immunity. *Id.* at 381.

As a threshold matter, Petitioners submit that all retired officers or employees of the United States are "similarly situated" with state and local government retirees for purposes of the tax immunity doctrine. *See generally, Davis*, 489 U.S. at 815-817.[7] Upon retirement,

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[7] This issue was not expressly addressed in *Davis*, but the decision cannot be read except as supporting the conclusion that retired federal employees are similarly situated with retired state and local government employees for purposes of 4 U.S.C. § 111 and principles of intergovernmental tax immunity. In addition to the holding in *Davis*, this Court observed that while the Public Salary Tax Act of 1939 "impose[d] federal

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each public officer or employee leaves active government service and receives nondisability retirement pay based on years of past service and highest qualifying rank or level of compensation attained.[8] All government retirees

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income tax on the salaries of all state and local government employees," it also consented to the imposition of nondiscriminatory state taxes on the pay or compensation of all federal officers and employees. *Davis*, 489 U.S. at 810-812. By this simultaneous action, Congress plainly intended all federal, state and local government employees to be equally subject to the burdens of both federal and state income taxation. Therefore, members of the class of government retirees are similarly situated for tax purposes.

[8] "Members of the Armed Forces who serve for a specified period, generally at least 20 years, may retire with a pension. 10 U.S.C. § 3911 *et seq.* (Army) (1982 ed. and Supp. V); § 6321 *et seq.* (1982 ed. and Supp. V) (Navy and Marine Corps); § 8911 *et seq.* (1982 ed. and Supp. V) (Air Force). The amount of retirement pay a veteran is eligible to receive is calculated according to the number of years served and the rank achieved." *Mansell v. Mansell*, 490 U.S. 581, 583 (1989). *See* 10 U.S.C.A. §§ 1401, 1406 and 1407 (West 1983 and Supp. 1991).

Federal civil servants who meet certain combined age and years of service requirements may retire and immediately begin receiving retirement benefits. *See* 5 U.S.C.A. § 8336 (West 1980 and Supp. 1991). For example, federal employees who complete "20 years of service as a law enforcement officer or firefighter" may retire at 50 years of age with a full retirement annuity. 5 U.S.C.A. § 8336(c)(1) (West 1980). For all federal civil servants, "the amount of benefits received in retirement is based and computed upon the individual's salary and years of service. 5 USC § 8339(a) [5 USCS § 8339(a)]." *Davis*, 489 U.S. at 808. Other federal retirement systems for civilian employees of the United States not covered by the federal civil service retirement system also share these same features.

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are "similarly situated" since they share these common characteristics and *"presumably should be taxed alike."* *Phillips Chemical Co.*, 361 U.S. at 381 [emphasis added].

"Because 'the Government's interests must be weighed in the balance,' " the presumption that federal retirees are entitled to equal tax treatment places a substantial burden on state taxing authorities to establish that differential taxation is "directly related to and 'justified by significant differences' " between the favored and the disfavored classes of taxpayers. *Davis*, 489 U.S. at 815-817; *Phillips Chemical Co.*, 361 U.S. at 383-385. In direct conflict with these settled principles, however, the Kansas Supreme Court improperly applied a presumption that the Kansas tax scheme is constitutional and resolved "all doubts . . . in favor of its validity." App. A at 9a.

B. The Kansas Tax Scheme Is Substantially Similar to the Michigan Scheme Invalidated in *Davis*.

Like Michigan's offensive tax scheme, KITA "defines taxable income in a manner that excludes all retirement

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By comparison, employees of Kansas and its political subdivisions may generally retire with full benefits after at least 10 years of service upon reaching a specified age or at any age with the completion of 40 years service. *See, e.g.*, Kan.Stat.Ann. § 74-4914(1) (Supp. 1990). For example, police officers and firefighters may retire with full benefits at age 55 following 20 years of service or at age 50 following 25 years of service. Kan.Stat.Ann. §§ 74-4957(1) and (3), 74-4955a(1) and 74-4957a(1) (Supp. 1990). For all such state and local government retirees, the amount of benefits received in retirement is based on and calculated in accordance with years of service and final average salary. *See, e.g.*, Kan.Stat.Ann. §§ 74-4915(1) and 74-4958(1) (Supp. 1990).

benefits received from the State or its political subdivisions, but includes most other forms of retirement benefits." *Davis*, 489 U.S. at 806. *See* Kan.Stat.Ann. § 79-32,116; Kan.Stat.Ann. § 79-32,117(a) and (c)(ii), (ix), (xiii) (Supp. 1990); App. A at 7a-8a and 29a.[9] By limited contrast, the Kansas scheme exempts annuities paid "from the [federal] civil service retirement and disability fund" and supplemental annuities paid to retired railway employees "under the provisions of 45 U.S.C. 228b(a) and 228c(a)(1) *et seq.*" Kan.Stat.Ann. §§ 79-32,117(c)(vii) and (viii) (Supp. 1990). *See* App. A at 8a. Nevertheless, the Kansas tax system is materially indistinguishable from Michigan's unlawful exemption scheme since all "Kansas income tax exemptions are identified strictly by source" of retirement

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[9] Most benefits paid to retired employees of Kansas and its political subdivisions are exempt under KITA as "amounts received which are included in federal adjusted gross income but which are specifically exempt from Kansas income taxation under the laws of the state of Kansas." Kan.Stat.Ann. § 79-32,117(c)(ii) (Supp. 1990). *See* App. A at 8a: Kan.Stat.Ann. §§ 74-4923(b) (Supp. 1990) [exempting retirement benefits paid under the Kansas Public Employees Retirement System ("KPERS") and Kansas Police and Fireman's Retirement System ("KP&F")]; 74-4978g (Supp. 1990) [exempting highway patrol pension fund benefits payable under KP&F]; 72-1768a and 72-17,122 [exempting benefits paid under the school employees' supplemental retirement system]; 12-111a, 12-5005 (Supp. 1990), 13-14a10 and 14-10a10 [exempting benefits paid to retired policemen and firemen under local retirement plans]; 20-2618 (Supp. 1990) [exempting benefits paid under the retirement system for state judges]; 74-49,105 [exempting benefits paid under the official court reporters retirement system]. Pertinent text from these statutory provisions is set forth in Appendix C at 47a-58a.

pay or compensation. App. A at 26a. *See* Kan.Stat.Ann. § 32,117(c) (Supp. 1990).

The Kansas Supreme Court considered the "net result" of this source-related Kansas exemption scheme to be that "benefits paid to federal civil service, railroad, state and local government retirees are exempt from Kansas income tax while benefits paid to military retirees are not." App. A at 10a-11a. This comparison, however, obscures the true nature and extent of the differential taxation at issue. Because the Kansas Supreme Court did not follow the unequivocal mandate to examine " 'the whole tax structure of the state,' " *Phillips Chemical Co.*, 361 U.S. at 383 [citation omitted], its selective approach ignores the harsh reality that Kansas taxes every federal retiree who receives retirement pay from any federal source other than the Civil Service Retirement and Disability Fund.

In addition to military retirement pay, Kansas also refuses to exempt the retirement pay received by all other federal retirees, including: Public Health Service ["PHS"] retirees paid under 42 U.S.C.A. § 212 (West 1991); National Oceanic and Atmospheric Administration ["NOAA"] retirees paid under 33 U.S.C.A. § 853o (West 1986 and Supp. 1991); Central Intelligence Agency ["CIA"] retirees paid under the Central Intelligence Agency Retirement and Disability Act of 1964 for Certain Persons, Pub. L. 88-643, 78 Stat. 1043 (Oct. 13, 1964), as amended [50 U.S.C.A § 403 note (West 1991)]; Foreign Service retirees paid from the Foreign Service Retirement and Disability Fund, 22 U.S.C.A. § 4041 *et seq.* (West 1990 and Supp. 1991); retired Justices and Judges of the United States paid under 28 U.S.C.A. § 371 (West 1968 and Supp. 1991); retired Claims Court judges paid under 28 U.S.C.A.

§ 178; and retired bankruptcy judges and magistrates paid under 28 U.S.C. § 377 (West Supp. 1991). *See* Kan. Stat. Ann. § 79-32,117(c) [no exemption for retirement benefits paid from these federal sources]; App. A at 29a. Since these federal retirees are similarly situated with all other government retirees for tax purposes, the treatment of their federal retirement pay under KITA cannot be ignored in any objective evaluation of the Kansas source-related exemption scheme.

The opinion below, however, expressly refused to consider the differential tax treatment of these other federal retirees on the basis that they do not have *"exactly the same characteristics* as the class of military retirees . . . " App. A at 29a [emphasis added]. This refusal fundamentally conflicts with the command "to determine how other taxpayers *similarly situated* are treated," *Phillips Chemical Co.*, 361 U.S. at 383 [emphasis added], and it impermissibly limits the constitutional inquiry to those government retirees who have "exactly the same characteristics."[10] By refusing to consider the disparate treatment of other "similarly situated" federal retirees, the opinion below likewise violates the analytical requirement to "focus on the nature of the classification" erected by the Kansas exemption scheme, *Phillips Chemical Co.*, 361 U.S. at 383, and it ignores convincing evidence of KITA's discriminatory purpose. Indeed, since the Kansas Supreme Court examined and considered the tax exempt

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[10] Since no two classes of federal, state or local government retirees have "exactly the same characteristics," the Kansas Supreme Court has erected a standard of review which, if allowed to stand, poses a direct threat to continued vitality of the nondiscrimination provisions of 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity.

treatment of all federal, state and local government retirees in the favored class created by KITA, its refusal to examine and consider the tax treatment of all federal retirees in the disfavored class is inconsistent and indefensible.

Comprehensive examination of the Kansas tax structure applicable to all government retirees clearly demonstrates that KITA favors all categories of state and local government retirees over virtually all categories of federal retirees based on the source of their retirement compensation. While source-related exemptions for retired federal civil servants and railway employees may "reduce the extent of the discrimination" created by KITA, "they obviously do not eliminate it." *Cf. Phillips Chemical Co.*, 361 U.S. at 381 n. 6. Retired officers or employees of the United States are the only government retirees whose retirement pay is subject to state income taxation and these disfavored federal retirees "would not be taxed at all if [their employer] were the State or one of its political subdivisions instead of the Federal Government." *Id.* at 382. The differential exemption scheme in Kansas is, therefore, substantially similar to the Michigan tax system repudiated by this Court, and it deserves the same fate. *See Davis*, 489 U.S. at 806 and 814-817.

C. Differential Taxation of Federal Military Retirees Is Not "Directly Related to" Any Significant Differences Between the Classes of Favored and Disfavored Government Retirees.

Relying upon *Davis* and certain federal cases having nothing to do with taxation or intergovernmental tax immunity, the Kansas Supreme Court concluded that differential taxation of military retirement pay is "directly

related to" its character as "reduced current compensation for reduced current services," while state and local government retirement pay is deferred compensation. App. A at 30a. The opinion below reasoned that there is a "direct relationship" between differential taxation and the alleged nature of retirement pay because "an evenhanded application of the rationale for taxing all members of one class (military retirees) does not result in taxation of some members of the other class (state and local government retirees)." App. A at 28a. These erroneous conclusions, however, are the result of an improper analytical approach and merit review.

The direct relationship test requires that statutory classifications which result in differential taxation must be "based on" significant differences between all members of the favored class of taxpayers and the disfavored class of taxpayers. *Phillips Chemical Co.*, 361 U.S. at 384. This test is not satisfied, however, unless the significant differences offered as justification furnish the actual reason for discrimination. *Davis*, 489 U.S. at 816-817. To paraphrase *Davis*, *"[a] tax exemption truly intended to account for differences in retirement benefits would not discriminate on the basis of the source of these benefits . . . ;* rather, it would discriminate on the basis of [asserted differences in retirement benefits]." *Id.* at 817 [emphasis added]. Therefore, a state exemption scheme which erects a source-related classification cannot survive scrutiny except where an evenhanded application of the proferred rationale for discrimination demonstrates that no members of the favored class should be taxed and no members of the disfavored class should be exempt from taxation.

Notwithstanding the existence of federal cases which view military retirement pay as "reduced current compensation for reduced current services," App. A at 24a, the opinion below fatally ignores the fact that KITA's source-related exemption scheme creates a *single disfavored class* of former federal officers or employees which includes: all recipients of military retired pay; all retired members of the PHS, NOAA, Foreign Service, and Article III judiciary; certain retired claims court judges, bankruptcy judges and magistrates; and certain retired members of the CIA.[11] All members of this class of federal

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[11] Claims Court judges, bankruptcy judges and magistrates who retire under either the Civil Service Retirement and Disability System [5 U.S.C.A § 8331 *et seq.* (West 1980 and Supp. 1991)] or the Federal Employees' Retirement System [5 U.S.C.A. § 8401 *et seq.* (West Supp. 1991) ("FERA")] are entitled to an exemption under Kan.Stat.Ann. § 79-32,117(c)(vii) (Supp. 1990) because their retirement pay is received from the "civil service retirement and disability fund." However, Claims Court judges who have retired or elect to retire under 28 U.S.C.A. § 178 (West Supp. 1991) receive retirement pay from the Claims Court Judges Retirement Fund which is fully taxable in Kansas because Kan.Stat.Ann. § 79-32,117(c) does not recognize this federal "source" of retirement pay as the basis for an exemption. Likewise, bankruptcy judges and magistrates who have retired or elect to retire under 28 U.S.C.A. § 377 (West Supp. 1991) receive retirement pay from the Judicial Officers' Retirement Fund which is fully taxable in Kansas because Kan.Stat.Ann. § 79-32,117(c) does not recognize this federal "source" of retirement pay as the basis for an exemption.

Members of the CIA who retire or elect to retire under FERA in accordance with Title III of the Central Intelligence Agency Retirement Act of 1964 [50 U.S.C.A. § 403 note (West 1991) (Title III, §§ 301 and 307)] receive tax exempt treatment under KITA because their retirement benefits are

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retirees receive disfavored tax treatment solely because KITA does not recognize the "source" of their retirement pay as the basis for an exemption. The Kansas tax system, therefore, impermissibly erects a source-related classification which uniformly burdens all members of the disfavored class regardless of the "nature" or characterization of their federal retirement pay. *Cf. Phillips Chemical Co.*, 361 U.S. at 384 [rejecting the State's proffered justification where the offensive tax statute "impose[d] its burdens on all federal lessees" in the disfavored class without regard to alleged differences in leasing activities].

Since many members of the disfavored class undoubtedly receive retirement pay which cannot be characterized as "reduced current compensation for reduced current services," an evenhanded application of this rationale cannot justify the discriminatory classification scheme under KITA. *See Davis*, 489 U.S. at 816-817 [rejecting Michigan's rationale for differential treatment since its uniform application to all members of the favored and disfavored classes would justify an exemption for some retired federal employees and taxation of some retired state employees]. If Kansas truly intended to

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paid from the "civil service retirement and disability fund." Kan.Stat.Ann. § 79-32,117(c)(vii). However, members of the CIA who retire under Title II of the Central Intelligence Agency Retirement Act of 1964 receive retirement pay from the Central Intelligence Agency Retirement and Disability Fund [50 U.S.C.A. § 403 note (Title II, §§ 202 and 211)] which is fully taxable because Kan.Stat.Ann. § 79-32,117(c) does not recognize this federal "source" of retirement pay as the basis for an exemption.

account for differences in the nature or characterization of retirement pay, it would not discriminate based on the source of payment and it would not tax any federal retirees in the disfavored class who receive deferred compensation. But KITA does both.[12]

Like the discriminatory tax scheme struck down in *Davis*, "Kansas income tax exemptions are identified strictly by source" of retirement pay, App. A at 26a, and no other factor plays any role in the exemption calculus. *Compare* Kan.Stat.Ann. § 79-32,117(c) (Supp. 1990) *with Davis*, 489 U.S. at 806 n.2 [quoting Mich. Comp. Laws Ann. § 206.30(1)(f) (Supp. 1988)]. Even if one assumes the propriety of comparing all federal, state and local government retirees in the favored class with a select subset of government retirees in the disfavored class, no statutory authority or legislative history in Kansas establishes any consistent reason for discrimination against federal military retirees except the "source" of their retirement pay.

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[12] This same reasoning applies with equal force to the noncontributory nature of the military retirement system. The Kansas Supreme Court concedes that other federal retirees participate in contributory plans but their retirement pay is taxed under KITA. App. A at 29a. If the Kansas exemption scheme truly intended to account for differences in contributory versus noncontributory retirement systems, it would not discriminate according to source of pay and it would not tax any federal retirees in the disfavored class who have made out-of-pocket contributions to their federal retirement plan. Likewise, Kansas would provide no tax exemption for employees of the state board of regents and educational institutions under its management who fund their retirement plans with nontaxable salary reductions, instead of taxable contributions, but it does. *See* Kan.Stat.Ann. §§ 74-4923(b) and 74-4925(1)(a) and (4) (Supp. 1990).

To the contrary, Kan.Stat.Ann. § 79-32,117(a) (Supp. 1990) utilizes federal adjusted gross income ["AGI"] as "the starting point" to determine "an individual's Kansas income tax liability." App A. at 7a. Irrespective of whether federal, state or local government retirement pay is viewed as current compensation for current services or deferred compensation, the Internal Revenue Code includes them all in federal AGI without regard to "source" of payment. *See* 26 U.S.C. § 61(a) (1988); App A at 7a-8a. Likewise, regardless of its source or characterization, 26 U.S.C.A. § 219 prohibits all Kansas residents from making tax deductible contributions to an Individual Retirement Account ["IRA"] based on "any amount received as a pension or annuity" and "any amount received as deferred compensation." 26 U.S.C.A. §§ 219(a), (b)(1) and (f)(1) (West Supp. 1991). *See* App. A at 24a-25a.

Internal Revenue Code §§ 61(a) and 219 have been incorporated by KITA as the law of Kansas. But since these Code sections do not differentiate between government retirement income based on its source or character, as in *Davis*, the Kansas Legislature's intended basis for differential tax treatment is expressly revealed by a classification scheme which discriminates against all retired officers or employees of the United States who receive benefits – regardless of their actual or perceived character – from a federal source which KITA does not recognize as the basis for an exemption. *See* Kan.Stat.Ann. § 79-32,117(c) (Supp. 1990).

In other relevant and related contexts, the Kansas Legislature also plainly recognizes and treats military

retirement pay as pension income or deferred compensation rather than current compensation. For example, federal military retirees are not authorized to purchase participating service credit under the Kansas Public Employees Retirement System for any period of "active service" in the Armed Forces which is "the basis for *military pension rights*." Kan.Stat.Ann. § 74-4919h(1) (Supp. 1990) [emphasis added]. *See also* Kan.Admin.Regs. § 80-3-16 (1989) [characterizing military retirement pay as "a military longevity pension" in KPERS implementing regulations]. This prohibition was enacted by the Kansas Legislature in 1974 to "preclude the doubling up of benefits under KPERS and the military pension system," REPORT OF SPECIAL COMMITTEES TO THE 1974 LEGISLATURE, RE: PROPOSAL NO. 22 - RETIREMENT MATTERS, at 22-13 (1974), and it vividly highlights the legislative belief that "military pension rights" are actually based on past military service instead of current service.

Like other forms of pension income or deferred compensation, military retirement pay is also divisible as "marital property" in actions for divorce, separate maintenance or annulment because the Kansas Legislature has expressly determined that "[a]ll property owned by married persons" specifically includes "the present value of any vested or unvested military retirement pay." Kan.Stat.Ann. § 23-201(b) (1988). This treatment of military retirement pay is significant for two compelling and undisputed reasons. First, the *"intent and purpose of the legislature* in adopting subsection (b)" of Kan.Stat.Ann. § 23-201 *"was clearly limited to affecting taxation"* by making the transfer of marital property "a nontaxable event" between co-owners. *Wachholz v. Wachholz*, 4 Kan.App.2d

161, 163-64, 603 P.2d 647 (1979) [legislative history citations omitted and emphasis added].[13]

Second, the legislative characterization and treatment of military retirement pay as "property" which "shall become marital property" in proceedings to dissolve marriage rests upon a premise – that military retirement pay is deferred compensation for services performed during *past* years of marriage – which repudiates any alleged basis for its consideration as "current compensation." *Cf. McCarty v. McCarty*, 453 U.S. 210, 221 (1981) ["The community property division of military retired pay rests on the premise that that pay, like a typical pension, represents deferred compensation for services performed during the marriage."]. At the philosophical core, these characterizations of military retirement pay are diametrically opposed and mutually exclusive.

The opinion below acknowledges that the Uniformed Services Former Spouses' Protection Act, Pub. L. No. 97-252, 96 Stat. 730 (1982) ["USFSPA"], authorizes the States to treat the disposable portion of military retirement pay as "marital property" and that the Kansas Legislature amended Kan.Stat.Ann. § 23-201(b) in 1987 to do so. App. A at 19a-20a. Since the amendment simply inserted the phrase "including the present value of any vested or unvested military retirement pay," 1987 Kan. Sess.

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[13] The opinion of the Kansas Court of Appeals in *Wachholz* has been expressly approved by the Kansas Supreme Court. *See Redmond v. Redmond*, 229 Kan. 565, 629 P.2d 142 (1981). *Cf. Cady v. Cady*, 224 Kan. 339, 581 P.2d 358 (1978) [filing a petition for divorce or separate maintenance creates a species of co-ownership in property acquired before and during marriage which avoids a taxable transfer of such property upon divorce or separation].

Laws, ch. 120, § 1, this permissible action simply reiterated the settled belief that such pay is a "military pension" or "military longevity pension" based on past years of creditable service. *See* Kan.Stat.Ann. § 74-4919h (Supp. 1990); Kan.Admin.Regs. § 80-3-16 (1989). The nature and effect of this legislative policy decision clearly rejected any supposed basis for characterizing military retirement pay as "current compensation" rather than as pension income or deferred compensation.

Nevertheless, in principal reliance upon *Cornetta v. United States*, 851 F.2d 1372, 1382 n.3 (Fed.Cir. 1987), and *United States v. Tafoya*, 803 F.2d 140, 142 n.7 (5th Cir. 1986), the Kansas Supreme Court concluded that "the USFSPA did not change the legal characterization of military retirement pay for any other purpose than cases involving marital property settlements." App. A at 21a and 21a-23a. This unsupported suggestion that existing federal case law involving nontax matters somehow prohibits the Kansas Legislature from characterizing or treating military retirement pay *for tax purposes* in the same manner as other federal, state or local government retirement benefits, however, directly conflicts with express congressional consent to "nondiscriminatory" state taxation of all pay or compensation received by active and retired employees of the United States. *See* 4 U.S.C. § 111 (1988). It also offers no meaningful insight into whether the Kansas Legislature "truly intended" to discriminate against federal military retirees on any basis other than the "source" of pay or compensation.

In the final analysis, the only expressions of actual legislative intent in Kansas demonstrate that the truly intended basis for discrimination against federal military retirees and all other federal retirees in the disfavored

class is the federal "source" of their retirement pay. The narrow and selective approach of the opinion below, however, disregards the fundamental nature and importance of the direct relationship test as a safeguard to protect the Federal Government's interests, and it reaches the wrong result based upon supposed differences that "have no direct relationship to a discriminatory tax scheme." *Kuhn*, ___ Colo. at ___, 1991 WL at 179971 at *6-7. Because the Kansas tax system does not actually rely upon supposed differences in the characterization or funding of retirement pay received by members of the disfavored class, this case merits review on certiorari to enforce the unequivocal mandate of 4 U.S.C. § 111 as reiterated and applied by this Court in *Davis*.

D. Differential Taxation of Federal Military Retirees Is Not "Justified By" Any Significant Differences Between the Classes of Favored and Disfavored Government Retirees.

The Kansas Supreme Court held that "[a] state is justified in taxing reduced current compensation paid for reduced current services while not taxing deferred compensation." App. A at 30a. Without explanation, the opinion below simply accepts the "rationale of the federal cases" to support this conclusion, even though none of these decisions involve taxation, intergovernmental tax immunity or discrimination against military retirees. Moreover, the court makes no effort to demonstrate that the supposed characterization of military retirement pay as compensation for current service has been endorsed by Congress for tax purposes; that it is a proper domestic concern of the State; or that it is directly related to a *legitimate* state interest.

Under codified principles of intergovernmental tax immunity, Congress does not recognize any distinctions between federal officers or employees who are entitled to protection from discriminatory state taxation. *See* 4 U.S.C. § 111. In view of the equal treatment objectives of the Public Salary Tax Act of 1939, it is significant that all forms of federal, state and local government retirement benefits, including military retirement pay, are subjected to the same burdens of income taxation under Internal Revenue Code §§ 61(a) and 219 regardless of their actual, intended or perceived character as one form of compensation or another.[14] Given these circumstances, the Kansas Supreme Court's stated reliance upon supposed differences in the nature of compensation to justify tax discrimination conflicts with the intent of Congress that military retirees receive the same tax treatment as all other federal, state and local government retirees. To paraphrase *Davis*: "It is difficult to imagine that Congress consented to discriminatory taxation of the pensions of retired [members of the Armed Forces] while refusing to permit such taxation of [its retired civil service] employees, and nothing in the statutory language or even in the legislative history [behind 4 U.S.C. § 111] suggests this result." *Davis*, 489 U.S. at 810.

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[14] Similarly, the Federal Insurance Contributions Act ["FICA"] does not tax any federal, state or local government retirement benefits, including military retirement pay, as "wages" or "remuneration for employment" despite actual or perceived differences in their character. *See* 26 U.S.C.A. §§ 3121(a)(5), (i)(2), (m), and (v)(3) (West Supp. 1991). In the same vein, the Social Security Act does not consider retirement income as "wages" or "wages for services" which can reduce social security benefit payments because of excess earnings "on account of work." 42 U.S.C.A. §§ 403(b) and (f)(5)(A) and (f)(5)(C)(i) (West 1983 and Supp. 1991).

The Kansas Supreme Court's discussion of intergovernmental tax immunity is also notably silent with respect to any legitimate state interest or proper domestic concern which is promoted by its alleged justification for discrimination. Nevertheless, the discriminatory exemption scheme exists as part and parcel of the State's retirement system, the primary purpose of which is to allow employees to retire "from *active service* without prejudice" or hardship, to provide for "old age, death and termination of employment," and to effect "economy and efficiency in the administration of government affairs." Kan.Stat.Ann. § 74-4901 (1985) [emphasis added]. *Cf.* App. A at 34a-35a [discussing these purposes in conjunction with a state constitutional issue]. By offering tax-exempt retirement benefits, Kansas plainly seeks to advance its interest "in hiring and retaining qualified employees," App. A at 35a, and in protecting its employees from economic hardship upon retirement, while minimizing its employment costs.

Recognizing the impermissible and offensive nature of promoting rational state interests through discrimination against the United States and its officers or employees, this Court cogently observed in *Davis*:

> In order to provide the same after-tax benefits to all retired state employees by means of increased salaries or benefit payments instead of a tax exemption, the State would have to increase its outlays by more than the cost of the current tax exemption, since the increased payments to retirees would result in higher federal income tax payments in some circumstances. *This fact serves to illustrate the impact on the Federal Government of the State's discriminatory tax exemption for state retirees. Taxes enacted to reduce*

> *the State's employment costs at the expense of the federal treasury are the type of discriminatory legislation that the doctrine of intergovernmental tax immunity is intended to bar.*

489 U.S. at 815 n.4. [emphasis added]. Like the Michigan statute struck down in *Davis*, the Kansas source-related exemption scheme violates intergovernmental tax immunity and 4 U.S.C. § 111 by unjustifiably reducing the State's employment costs at the expense of the United States and its retirees in the disfavored class.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari to the Supreme Court of the State of Kansas should be granted.

Respectfully submitted,

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APPENDIX A

No. 65,848

KEYTON BARKER and PAULINE BARKER, *et al.*, *Appellants*, v. STATE OF KANSAS, *et al.*, *Appellees*.

SYLLABUS BY THE COURT

1. STATUTES – *Constitutionality – Court's Duty to Uphold Constitutionality if Possible.* The constitutionality of a statute is presumed and all doubts should be resolved in favor of its validity. Before the statute may be struck down, it must clearly appear the statute violates the Constitution. It is this court's duty to uphold the statute under attack, if possible, rather than defeat it. If there is any reasonable way to construe the statute as constitutional, the court should do so.

2. SAME – *Kansas Income Tax Act – Constitutionality of Tax Imposed on Military Retirement Pay.* The Kansas Income Tax Act, K.S.A. 79-3201 *et seq.*, is constitutional. The differential tax treatment created by a state income tax imposed on federal military retirement benefits while exempting benefits received by other retirees is directly related to and justified by significant differences between the two classes of retirees and, consequently, meets the requirements of *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 103 L. Ed. 2d 891, 109 S. Ct. 1500 (1989).

3. SAME – *Kansas Income Tax Act – Constitutionality of Tax Imposed on Military Retirement Pay.* The Kansas Income Tax Act, K.S.A. 79-3201 *et seq.*, does not discriminate against federal military retirees in a manner that violates 4 U.S.C. § 111 (1988) and the constitutional principles of intergovernmental tax immunity and Article 11, § 2 of the Kansas Constitution.

4. KANSAS CONSTITUTION – *Income Tax Restrictions.* Article 11, § 2 of the Kansas Constitution prohibits the State from levying or collecting income taxes based upon classifications which are arbitrary, capricious, and discriminatory. A discriminatory tax must have a reasonable relationship to the subject of the right and privilege taxed. Nothing forbids different taxation of different classes where there is a reasonable basis for differentiation.

5. TAXATION – *Income Tax – Constitutionality of Tax Imposed on Military Retirement Benefits – State Has Rational Reason for Discriminating between State and Federal Retirees.* The Kansas Income Tax Act, K.S.A. 79-3201 *et seq.*, bears a reasonable relationship to the subject taxed and is not arbitrary and capricious and, thus, does not violate Article 11, § 2 of the Kansas Constitution. The State has a "rational reason" for discriminating between state and federal retirees when it seeks to advance its interest in hiring and retaining qualified state and local government employees by offering tax-free retirement benefits.

Appeal from Shawnee district court; ADRIAN J. ALLEN, judge. Opinion filed July 12, 1991. Affirmed.

Kevin M. Fowler, of Frieden, Haynes & Forbes, of Topeka, argued the cause, and *John C. Frieden* and *Wendell Betts*, of the same firm; *Kenton C. Granger*, *Raymond L. Dahlberg*, *Angela K. Green*, and *Kristin L. Altice*, of Niewald, Waldeck & Brown, of Overland Park; *Terence A. Lober*, of Davis, Beall, McGuire & Thompson, Chartered, of Leavenworth; and *Mark G. Ayesh*, *Michael D. Herd*, and *Roger M. Theis*, of Ayesh, Docking, Herd & Theis, of Wichita, were with him on the briefs for appellants.

James Bartle, attorney, Kansas Department of Revenue, argued the cause, and *Mark A. Burghart*, general counsel, and *Michael M. Rehm*, attorney, were with him on the briefs for appellees.

The opinion of the court was delivered by

Six, J.: This is a constitutional law case. Plaintiffs/taxpayers (retired military), in consolidated class actions, challenge the taxing of federal military retirement benefits under the Kansas Income Tax Act (KITA), K.S.A. 79-3201 *et seq.* State and local government retirement benefits are not taxed under KITA.

The plaintiffs/taxpayers appeal from the trial court's memorandum decision and order, which denied their motion for summary judgment and entered summary judgment in favor of the defendants (the State, the Department of Revenue, and two state officials). The trial court upheld the differential tax treatment of federal military retirement benefits under KITA.

Is K.S.A. 79-3201 *et seq.* constitutional? The primary issue is whether the inconsistent tax treatment is directly related to and justified by significant differences between federal military retirees taxed by Kansas and other retirees not taxed by Kansas.

Our jurisdiction is under K.S.A. 20-3017. We granted the taxpayers' motion to transfer from the Court of Appeals.

We find no error and affirm. K.S.A. 79-3201 *et seq.* is constitutional.

Facts

On March 28, 1989, the United States Supreme Court held that a Michigan statute imposing a state income tax on retirement benefits of federal civil service retirees,

while exempting retirement benefits of State retirees, violated the doctrine of inter-governmental tax immunity. *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 103 L. Ed. 2d 891, 109 S. Ct. 1500 (1989).

On April 17, 1989, the instant class action suits were filed challenging the validity of the provisions of KITA. The challenged provisions tax federal military retirement benefits while exempting retirement benefits received by state and local government retirees.

All named plaintiffs in the instant action are Kansas residents who are retired members of the United States Armed Forces and, where applicable, their joint taxpayer spouses. They have paid Kansas income taxes on federal military retirement pay during one or more years from 1984 through 1989. The certified class is defined as:

"[A]ll retired members of the federal or United States armed forces who are recipients of federal armed forces retirement benefits [under applicable provisions of Title 10 or Title 14 or the United States Code] subject to Kansas state income taxation during one or more of the tax years from 1984 through 1989 and, where applicable, their respective spouses who have filed or will file joint Kansas state income tax returns during one or more of the tax years from 1984 through 1989."

There are approximately 14,000 military retirees who are members of the class.

Defendants are the State of Kansas, the Kansas Department of Revenue, Secretary of Revenue Ed Rolfs, and Acting Director of Taxation Steve Stotts. Defendants Rolfs and Stotts are named in their official capacity as administrators charged with enforcement of KITA.

The Taxpayers' Claims

The taxpayers claim KITA discriminates against federal military retirees and, therefore, violates: (1) 4 U.S.C. § 111 (1988), and constitutional principles of intergovernmental tax immunity as discussed and applied in *Davis;* (2) the supremacy clause of the United States Constitution; (3) the privileges and immunities clause of the Fourteenth Amendment of the United States Constitution; and (4) Article 11, § 2 of the Kansas Constitution. The taxpayers also allege deprivation of their civil rights as secured by the United States Constitution and laws in violation of the Fourteenth Amendment and of 42 U.S.C. § 1983 (1988).

The taxpayers sought declaratory judgment that KITA is unconstitutional as applied to federal military retirees and that military retirement pay is exempt from Kansas income taxation for tax years 1984 to the present. The taxpayers also seek a permanent injunction prohibiting defendants from levying, assessing, and/or collecting Kansas income taxes on military retirement benefits. Refunds of Kansas income tax paid by members of the plaintiff class on their military retirement benefits from tax years 1984 to the present (with interest at the rate of 12% per year until paid) and costs including reasonable attorney fees under 42 U.S.C. § 1988 (1988), are also requested.

The taxpayers filed a motion for summary judgment. They argued that under *Davis* KITA is unconstitutional because it discriminates in favor of state and local government retirees and against federal military retirees based on the source of retirement benefits. Taxpayers

further argued that the inconsistent tax treatment is neither directly related to nor justified by significant differences between the classes of retirees.

Defendants' Claims

The defendants responded to the taxpayers' contentions by arguing that the inconsistent tax treatment of the two classes of retirees is directly related to, and justified by, significant differences between the two classes; that *Davis* has been complied with; and that the Kansas income tax law is supported by a rational basis and does not violate the Kansas Constitution. Defendants also argued that the taxpayers are not entitled to relief under 42 U.S.C. § 1983 because: (1) the State of Kansas and the Kansas Department of Revenue are not "persons" under § 1983; (2) the Secretary of Revenue and the Director of Taxation, acting in their official capacities, are not "persons" under § 1983; (3) exhaustion of administrative remedies is required before a state tax may be challenged under § 1983; and (4) 4 U.S.C. § 111 does not create enforceable individual rights. Finally, defendants asserted that if the court finds KITA invalid, the taxpayers are not entitled to retrospective relief under either federal law or K.S.A. 79-32,105(c).

The Trial Court's Decision

The trial court entered its memorandum decision denying the taxpayers' motion for summary judgment and entered summary judgment *sua sponte* for defendants. The trial court held that KITA, as applied to military retirement pay, is constitutional and does not violate

4 U.S.C. § 111. Finding that there are substantial differences between the two classes (military retirees and state and local government retirees) justifying the disparate tax treatment, the trial court stated:

"Viewed in toto the military retired system is unique to other retirement systems, especially in light of the fact that military retirees are subject to recall and during active service do not contribute to their retired pay. The absence of contribution during active service by military retirees or by their employer, the Federal Government, is consistent with the [*United States v.*] *Tyler,* [105 U.S. (15 Otto) 244, 26 L. Ed. 985 (1881),] and *McCarty* [*v. McCarty,* 453 U.S. 210, 69 L. Ed. 2d 589, 101 S. Ct. 2728 (1981),] decisions which state military retired pay is reduced compensation for reduced current services."

The trial court considered all other issues raised by the parties and found them to be without merit. Finding KITA valid, the trial court did not address the request for refunds. The trial court stated that defendant's motion for partial summary judgment on the civil rights claim under 42 U.S.C. § 1983 was moot.

The Relevant KITA Tax Scheme

Under KITA, federal adjusted gross income (AGI) is the starting point for determining an individual's Kansas income tax liability. An individual's Kansas AGI is an individual's federal AGI, subject to certain modifications. K.S.A. 1990 Supp. 79-32,117(a). An individual's Kansas taxable income is Kansas AGI less Kansas deductions and exemptions. K.S.A. 79-32,116.

Federal AGI includes military retirement benefits and state and local government retirement benefits, 26 U.S.C.

§ 61(a) (1988). Retirement benefits received from the Kansas Public Employees Retirement System (KPERS) are subtracted from federal AGI to arrive at Kansas AGI and are exempt from Kansas income tax. K.S.A. 1990 Supp. 72-32,117(c)(ii). See K.S.A. 1990 Supp. 74-4923(b) (also exempts benefits paid under the Kansas Police and Fireman's Retirement System [KP&F]). There are similar statutory exemptions for benefits received by other retired state and local employees. K.S.A. 1990 Supp. 74-4978g (benefits from the highway patrol pension fund payable under KP&F); K.S.A. 72-1768a and K.S.A. 72-17,122 (benefits paid under the school employees' supplemental retirement system); K.S.A. 1990 Supp. 20-2618 (benefits paid under retirement systems for judges); K.S.A. 12-111a, K.S.A. 1990 Supp. 12-5005, K.S.A. 13-14a10, and K.S.A. 14-10a10 (benefits paid to policemen and firemen under local retirement plans); K.S.A. 1990 Supp. 79-32,117(c)(ix) (benefits paid to retired city employees); and K.S.A. 1990 Supp. 79-32,117(c)(xiii) (benefits paid to retired employees of a board of public utilities).

Certain federal retirement benefits are also subtracted from federal AGI to arrive at Kansas AGI and are exempt from Kansas income tax. Benefits received as annuities under the federal civil service retirement system or benefits received by retired railroad employees are exempted from Kansas income tax. K.S.A. 1990 Supp. 79-32,117(c)(vii) and (viii).

Military retirement benefits are not subtracted from federal AGI and are included in Kansas AGI under KITA. Military retirement benefits are subject to Kansas income tax. Military retirees age 62 or older are entitled to a $120 tax credit against Kansas income tax. K.S.A. 79-32,111b.

The net result is that benefits paid to federal civil service, railroad, state, and local government retirees are exempt from Kansas income tax while benefits paid to military retirees are not.

Presumption of Constitutionality

In determining the constitutionality of K.S.A. 79-3201 *et seq.*, we note the following principles: Construction of a statute is a question of law, and it is the function of this court to construe a statute to give it the effect intended by the legislature. *NCAA v. Kansas Dept. of Revenue*, 245 Kan. 553, 557, 781 P.2d 726 (1989).

The constitutionality of a statute is presumed and all doubts should be resolved in favor of its validity. Before the statute may be struck down, it must clearly appear the statute violates the Constitution. It is this court's duty to uphold the statute under attack, if possible, rather than defeat it. If there is any reasonable way to construe the statute as constitutional, we should do so. *Guardian Title Co. v. Bell*, 248 Kan. 146, 149, 805 P.2d 33 (1991). However, when legislation encroaches upon constitutional provisions, it is our duty and obligation to declare the legislation unconstitutional. *Berentz v. Comm'rs of Coffeyville*, 159 Kan. 58, 62-63, 152 P.2d 53 (1944).

Intergovernmental Tax Immunity and the *Davis* Decision

The taxpayers filed the instant action in response to the United States Supreme Court's decision in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 103 L. Ed. 2d 891,

109 S. Ct. 1500 (1989). In *Davis*, a retired federal government employee receiving federal civil service retirement benefits challenged the Michigan Income Tax Act (MITA). MITA is similar to KITA. MITA commences with federal adjusted gross income to define Michigan taxable income and allows a deduction for all benefits received from public retirement systems created by the State of Michigan or its political subdivisions. MITA limits the deduction for most other retirement benefits, including federal civil service retirement benefits, to $7,500 for a single return and $10,000 for a joint return. *Davis*, 489 U.S. at 806 n.2.

Davis challenged the taxation of his federal civil service retirement benefits under the doctrine of intergovernmental tax immunity and 4 U.S.C. § 111. 4 U.S.C. § 111 provides in relevant part:

"The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States . . . by a duly constituted tax authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation."

The doctrine of intergovernmental tax immunity carries a traceable lineage to *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 4 L. Ed. 579 (1819). *McCulloch* held that a state may not impose a discriminatory tax on the Bank of the United States. The United States Supreme Court, speaking through Chief Justice John Marshall, reasoned that the Bank was an instrumentality of the federal government and taxation by the state would interfere with the exercise of federal powers delegated to the Bank.

This doctrine was more fully developed in *Helvering v. Gerhardt*, 304 U.S. 405, 82 L. Ed. 1427, 58 S. Ct. 969 (1938) (the federal government could levy nondiscriminatory taxes on the income of most state employees), and *Graves v. N.Y. ex rel. O'Keefe*, 306 U.S. 466, 83 L. Ed. 927, 59 S. Ct. 595 (1939) (federal employees were subject to nondiscriminatory taxes levied by the states). "After *Graves*, therefore, intergovernmental tax immunity barred only those taxes that were imposed directly on one sovereign by the other or that discriminated against a sovereign or those with whom it dealt." *Davis*, 489 U.S. at 811.

In effect, 4 U.S.C. § 111 codified the result in *Graves*. The final clause of § 111, "if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation," makes it clear that immunity from taxation was waived for only nondiscriminatory taxes. Because § 111 embodied the modern constitutional doctrine of intergovernmental tax immunity, the United States Supreme Court in *Davis* concluded that the dispositive question was whether MITA violated the doctrine of intergovernmental tax immunity. *Davis*, 489 U.S. at 813-14.

Relying on *Phillips Co. v. Dumas School Dist.*, 361 U.S. 376, 383-85, 4 L. Ed. 2d 384, 80 S. Ct. 474 (1960), the *Davis* court stated: "[T]he relevant inquiry is whether the inconsistent tax treatment is directly related to, and justified by, 'significant differences between the two classes.' " 489 U.S. at 816.

Michigan unsuccessfully asserted two allegedly significant differences between federal and state retirees.

First, Michigan argued that its interest in hiring and retaining qualified civil servants through the inducement of a tax exemption for retirement benefits justified the preferential treatment of its retired employees. The United States Supreme Court rejected this argument, stating the argument does nothing to demonstrate differences between the classes, but merely demonstrates that Michigan has a rational basis for discriminating between the two similar classes. Michigan's interest, no matter how substantial, was irrelevant. 489 U.S. at 816. An equal protection analysis is irrelevant in the context of intergovernmental immunity. See *Phillips Co.*, 361 U.S. at 383-85.

Second, Michigan argued that its retirement benefits are significantly less munificent than federal retirement benefits in terms of vesting requirements, rate of accrual, and computation of benefit amounts. The substantial differences in the value of the retirement benefits, in Michigan's view, justified the inconsistent tax treatment, 489 U.S. at 816. The *Davis* Court rejected this argument by pointing out that, while the average federal civil servant receives a larger pension than his state counterpart, there are undoubtedly instances in which the opposite is true. The Court stated: "A tax exemption truly intended to account for differences in retirement benefits would not discriminate on the basis of the source of those benefits, as Michigan's statute does; rather, it would discriminate on the basis of the amount of benefits received by individual retirees." 489 U.S. at 817.

The *Davis* Court concluded that MITA violated principles of intergovernmental tax immunity by favoring retired state and local government employees over retired

federal government employees. Michigan conceded that a refund was appropriate; therefore, *Davis* did not address the issue of retrospective relief. *Davis* was remanded on the issue of prospective relief. The *Davis* Court stated that discriminatory taxation could be avoided by either extending the exemption to federal retirees or removing the exemption for state and local retirees, but recognized that the Michigan courts are in the better position to determine how to comply with the mandate of equal treatment. 489 U.S. at 817-18.

Davis relied on *Phillips*, 361 U.S. 376. In *Phillips*, the State of Texas imposed a tax measured by the full value of real property owned by the United States upon the lessee of that property (Phillips Chemical Co.). Real property owned by the United States was exempt from tax. Lessees of exempt property owned by the state and its political subdivisions, with similar lease provisions, were not taxed on their leaseholds.

A unanimous Supreme Court reversed the Texas Supreme Court, holding that the tax imposed on federal government lessees unconstitutionally discriminated against the United States and those with whom it dealt. 361 U.S. at 387. Because the discrimination was apparent, the Court stated: "The imposition of a heavier tax burden on lessees of federal property than is imposed on lessees of other exempt public property must be justified by significant differences between the two classes." 361 U.S. at 383.

Texas argued three differences justified the disparate tax treatment: (1) The State can collect in rent what it loses in taxes from its own lessees, which it cannot do

with federal government lessees; (2) the State may foster its own interests by adopting measures which facilitate the leasing of its property; and (3) the greater magnitude of the federal leasing of exempt land has a greater impact on the finances and operations on local government than does the State's leasing activities. 361 U.S. at 383-84.

The Court in *Phillips* found none of these considerations justified the disparate tax treatment. In regard to the first proffered justification, the Court reasoned that what the Texas political subdivisions lose in taxes from the State's lessees is not made up in increased rent. Other local taxpayers, including the federal government's lessees, must make up the difference. The State's second proffered justification was a legitimate state objective; however, the discriminatory taxation of the federal government's lessees was impermissible regardless of the State's legitimate objective. As to the alleged greater impact of federal leasing, the Court stated that the taxing statute was not based on this difference. The taxing statute imposed its burdens on *all* lessees of government property with no relation to the impact on local government. 361 U.S. at 384-85.

Unfortunately, neither *Davis* nor *Phillips* provide further guidance on how to determine whether the inconsistent tax treatment is "directly related to, and justified by, 'significant differences between the two classes.' "

One post-*Davis* commentator has observed that the courts are now left without easy guidelines to determine whether a state tax is discriminatory. Note, Rejection of the "Similarly Situated Taxpayer" Rationale: *Davis v.*

Michigan Department of Treasury, 43 Tax Law. 431, 439-40 (1990).

KITA exempts federal civil service retirement benefits from taxation. In this respect, *Davis* is not directly on point. The crucial issue in the case at bar is whether the inconsistent taxation of federal military retirement benefits is "directly related to, and justified by, 'significant differences' " between federal military retirees and state and local government retirees.

The Taxpayers' Contentions

The taxpayers contend that the inconsistent tax treatment of military retirees is not directly related to, and justified by, significant differences between the two classes. They advance various arguments, sometimes overlapping, to support their "no significant difference" contention.

The taxpayers argue that federal military retirees and state and local government retirees are similarly situated and should be treated the same under KITA. In other words, there are no *significant* differences between the two classes. In support of this argument, they assert the trial court emphasized *immaterial* differences. The taxpayers point to the following similar characteristics: (1) both federal military retirees and state and local government retirees are entitled to retire and receive retirement benefits upon satisfying statutory requirements for eligibility; (2) upon retirement both classes of retirees leave active government service; (3) retirees of each class receive retirement benefits based on their number of years of service and their highest salary received before

retirement; and (4) Kansas treats both federal military retirement benefits and state and local government retirement benefits as deferred compensation.

The Defendants' Contentions

Defendants counter, contending that federal military retirees and state and local government retirees are not similarly situated. Defendants mark the following differences: (1) federal military retirees remain members of the armed forces of the United States after they retire from active duty; they are retired from active duty only; (2) federal military retirees are subject to the Uniform Code of Military Justice (UCMJ) and may be court martialed for offenses committed after retirement; (3) they are subject to restrictions on civilian employment after retirement; (4) federal military retirees are subject to involuntary recall; (5) federal military retirement benefits are not deferred compensation but current pay for continued readiness to return to duty; and (6) the federal military retirement system is noncontributory and funded by annual appropriations from Congress; thus, all benefits received by military retirees have never been subject to tax.

In contrast, defendants assert: State and local government retirees are completely severed from employment and have no continuing connection with government employers. State and local retirees are not subject to government personnel procedures or disciplinary rules, and there are no restrictions on their post-retirement activities. State and local government retirees are not subject to involuntary recall. State and local government

retirement benefits are deferred compensation, not current pay. KPERS benefits are funded by regular employee and employer contributions. Participation in KPERS is mandatory, and state employees are required to make contributions to KPERS after working for the State for one year. Employee contributions to KPERS are subject to Kansas income tax in the year in which they are made; thus, KPERS benefits received by State employees include these previously taxed contributions.

The first four differences between military and state and local government retirees asserted by defendants support the contention that federal military retirement benefits are reduced compensation for reduced current services. The reduced compensation for reduced current services difference was the basis for the trial court's decision in the case at bar. Relying on *McCarty v. McCarty*, 453 U.S. 210, 69 L. Ed. 2d 589, 101 S. Ct. 2728 (1981), *United States v. Tyler*, 105 U.S. (15 Otto) 244, 26 L. Ed. 985 (1881), and *Cornetta v. United States*, 851 F.2d 1372 (Fed. Cir. 1988), the trial court found "that due to the United States Supreme Court's characterization of military retired pay as reduced compensation for reduced current services the KITA must be found constitutional."

The Federal Cases

The United States Supreme Court held in *Tyler* that a retired military officer was entitled to the benefit of a statute that increased the pay of commissioned officers for every five years of service. The statute applied to the years in the service after retirement as well as before. The Court stated with reference to military retirement pay:

"[C]ompensation is continued at a reduced rate, and the connection is continued, with a retirement from active service only." 105 U.S. at 245. The *Tyler* Court concluded:

"It is impossible to hold that men who are by statute declared to be part of the army, who may wear its uniform, whose names shall be borne upon its register, who may be assigned by their superior officers to specified duties by detail as other officers are, who are subject to the rules and articles of war, and may be tried, not by a jury, as other citizens are, but by a military court-martial, for any breach of those rules, and who may finally be dismissed on such trial from the service in disgrace, are still *not* in the military service." 105 U.S. at 246.

In *McCarty*, an Army officer challenged a California Superior Court ruling that his "military pension and retirement rights" were subject to division as quasi-community property upon dissolution of marriage. 453 U.S. at 218. The California Court of Appeals affirmed, relying on *In re Marriage of Fithian*, 10 Cal. 3d 592, 111 Cal. Rptr. 369, 517 P.2d 449, *cert. denied* 419 U.S. 825 (1974),which held that military retirement was properly subject to division as community property upon divorce. The California Supreme Court denied McCarty's petition for hearing. 453 U.S. at 218-19.

On appeal to the United States Supreme Court, McCarty argued that "military retired pay in fact is current compensation for reduced, but currently rendered, services" and may not be treated as community property since it is earned after the dissolution of the marriage. 453 U.S. at 221. The United States Supreme Court noted that military retired pay differs in some significant respects from a typical retirement plan: The retired officer remains

a member of the Army; the officer continues to be subject to the Uniform Code of Military Justice; the officer may forfeit all or part of retirement pay if certain activities are engaged in; and the retired officer remains subject to recall to active duty at any time. 453 U.S. at 221-22. The *McCarty* Court stated: "These factors have led several courts, *including this one*, to conclude that military retired pay is reduced compensation for reduced current services." (Emphasis added.) 453 U.S. at 222.

We consider the "retired pay is reduced compensation for reduced current services" characterization by the United States Supreme Court in *McCarty* to be significant in resolving the issue before us in the case at bar.

The Court in *McCarty* declined to decide whether federal law prohibits a state from characterizing retired pay as deferred compensation. The Court accepted McCarty's alternative argument that California's community property laws improperly interfered with the federal military system, which indicated that Congress intended military retirement pay to be a personal entitlement of the retiree.

In response to *McCarty*, Congress enacted the Uniformed Services Former Spouses' Protection Act (USFSPA), Pub. L. No. 97-252, 96 Stat. 730 (1982). The USFSPA includes 10 U.S.C. § 1408(c)(1) (1988), which authorizes state courts to treat disposable retired pay as marital property. *Mansell v. Mansell*, 490 U.S. 581, 584-85, 104 L. Ed. 2d 675, 109 S. Ct. 2023 (1989). "Disposable retired or retainer pay" is defined as "the total monthly retired or retainer pay to which a member is entitled," less certain deductions. 10 U.S.C. § 1408(a)(4).

Following congressional enactment of the USFSPA, the Kansas Court of Appeals held that military retirement pay was not marital property and was nothing more than a future stream of income which will cease at the death of the retiree. *Grant v. Grant*, 9 Kan. App. 2d 671, 676, 685 P.2d 327, *rev. denied* 236 Kan. 875 (1984). The Court of Appeals concluded: "[M]ilitary retirement pay has no present determinable value which would qualify it as a marital asset subject to division.' 9 Kan. App. 2d at 676. In 1987, Kansas amended K.S.A. 23-201(b) (Ensley 1981) to treat military retirement pay as marital property upon commencement of an action for divorce, separate maintenance, or annulment.

The taxpayers argue that regardless of federal case law, Kansas has opted to treat military retirement pay as marital property and, therefore, not current income. The taxpayers assert that Kansas may not rely on federal case law involving nontaxation issues which state that military retired pay is reduced compensation for reduced current services.

Defendants counter the taxpayers' argument by reasoning that the USFSPA authorizes states to treat military retirement pay as marital property only between spouses in divorce cases. Furthermore, under K.S.A. 23-201(b), military retirement pay is not considered marital property until the commencement of an action for divorce, separate maintenance, or annulment. Defendants reason taxpayers have not alleged the commencement of such an action; consequently, Kansas does not consider their military retirement pay as marital property.

The trial court rejected the taxpayers' K.S.A. 23-201(b) argument, relying on *Cornetta v. United States*, 851 F.2d 1372. The trial court reasoned that the USFSPA did not change the legal characterization of military retirement pay for any other purpose than cases involving marital property settlements. We agree.

Cornetta involved a retired Marine officer who brought a wrongful discharge claim against the government approximately seven years after his discharge. The federal district court dismissed the action on the grounds of laches, finding that the seven-year delay was unreasonable and that the government had been prejudiced by the delay. Initially, the Court of Appeals affirmed the federal district court holding. *Cornetta v. United States*, 831 F.2d 1039 (Fed. Cir. 1987). On motion for rehearing, the court reversed, finding in part that the possibility that the officer might receive increased retirement benefits was not sufficient economic prejudice to the government. The Court of Appeals reasoned:

"Retired pay is reduced pay for reduced current services. *Hotinsky v. United States*, 292 F.2d 508, 510, 154 Ct. Cl. 443 (1961) (an officer draws retired pay because he is 'still an officer' in service of country); *Lemly v. United States*, 75 F. Supp. 248, 249, 109 Ct. Cl. 760 (1948) (an officer receiving retired pay 'is still an officer in the service of his country even though on the retired list'); *see United States v. Tafoya*, 803 F.2d 140, 142 (5th Cir. 1986) (retired pay is " 'current pay" designed in part to compensate [an officer] for his continuing readiness to return to duty should his country have need to call upon him'); *Costello v. United States*, 587 F.2d 424, 427 (9th Cir. 1978) ('retirement pay does not differ from active duty pay in its character as pay for continuing military service'); *Berkey v. United States*, 361 F.2d 983, 987 n.9, 176 Ct. Cl. 1 (1966) (retired

pay 'has generally not been considered a pension, grant, or gratuity, but as something the serviceman earns and has earned'). . . .

"Unlike an award of back pay where the government in effect pays for unperformed service, receipt of retired pay by an officer means the government will pay for the reduced service it then receives. This is no detriment; the government gets what it pays for." 851 F.2d at 1382.

Cornetta noted that 10 U.S.C. § 1408(c)(1) did not affect the characterization of military retired pay as reduced compensation for reduced current services. 851 F.2d at 1382 n.3 (citing *United States v. Tafoya*, 803 F.2d 140, 142 n.7 [5th Cir. 1986]).

We consider the status analysis of military retirement pay found in *Cornetta* significant.

In *Tafoya*, the defendant appealed from a court order withholding a portion of his army retirement pay to repay the government for services rendered by a public defender. The *Tafoya* court noted: "By some quirk of history, however, Tafoya's retirement pay is actually not 'retirement pay'; it is instead 'current pay' designed in part to compensate Tafoya for his continuing readiness to return to duty should his country have need to call upon him." 803 F.2d at 142 (citing *McCarty*). Current pay may not be offset absent specific statutory authority. The court in *Tafoya* noted that *McCarty* had been superseded by statute but found that the classification of military retired pay as current pay remains viable. 803 F.2d at 142 n.7. After determining military retired pay is current pay, the court denied the right of setoff, finding no statutory authority to set off Tafoya's pay. 803 F.2d at 143. *Tafoya's* "current pay" determination of military retired pay

extends cumulative support to affirmance of the trial court in the instant case.

In *Costello v. United States*, 587 F.2d 424 (9th Cir. 1978), military retirees brought suit to challenge statutory changes to military retirement compensation. The retirees argued that military retirement pay is deferred compensation for past services, which could not be prospectively altered. The Ninth Circuit rejected this argument, finding that military retirement pay does not differ from active duty pay in its character as pay for continuing military service. The compensation could be prospectively altered without offending due process. 587 F.2d at 427-28. *Costello* provides a Ninth Circuit endorsement of the similar character of military retired pay and active duty pay.

In *In re Siverling*, 72 Bankr. 78 (Bankr. W.D. Mo. 1987), creditors objected to the debtor's claim that his military retirement pay was not property of the estate under 11 U.S.C. § 541(a)(6) (1988). 11 U.S.C. § 541(a)(1) provides that the bankruptcy estate consists of "all legal or equitable interests of the debtor in property as of the commencement of the case." However, "earnings from services performed by an individual debtor after the commencement of the case" are not property of the estate. 11 U.S.C. § 541(a)(6). The court cited *Tyler* and *McCarty*, finding military retirement pay is "reduced compensation for reduced current services" and not property of the estate. 72 Bankr. at 78-79.

These federal cases offer interpretative assistance and demonstrate the current vitality of *Tyler's* conclusion in

1881 that military retirement pay is reduced current compensation for reduced current services. In addition, *Cornetta*, *Tafoya*, and *Siverling*, all post-USFSPA cases, indicate that the USFSPA has not changed the federal characterization of military retirement pay as reduced current compensation for reduced current services.

The IRA Deduction

The taxpayers also argue that KITA considers military retirement pay as a pension, annuity, or deferred compensation; therefore, KITA may not also consider military retirement pay as current compensation. Because Kansas utilizes federal AGI to calculate Kansas taxable income, Kansas has incorporated 26 U.S.C. § 219 (1988) into KITA.

26 U.S.C. § 219 governs the deductibility of taxpayer contributions to an individual retirement account (IRA). The IRA deduction is limited to the amount of the taxpayer's "compensation" for the tax year. 26 U.S.C. § 219(b). For purposes of § 219, "the term 'compensation' does not include any amount received as a pension or annuity and does not include any amount received as deferred compensation." 26 U.S.C. § 219(f)(1). Each "active participant" in a retirement or pension plan "established for its employees by the United States, by a state or political subdivision thereof, or by an agency or instrumentality of any of the foregoing," is subject to further limitations on the IRA deductions which may render the deduction unavailable. 26 U.S.C. § 219(g)(1), (2), and (5)(A)(iii).

Under § 219(f)(1), "Retirement income, including federal, civil and military retirement income, is not compensation for purposes of making deductible contributions to an IRA." 6 Mertens Law of Federal Income Taxation § 25C.12, p. 58 (1988).

"This interpretation is consistent with the legislative intent behind the enactment of the tax law relating to IRAs. The purpose of an IRA is to give employees or self-employed individuals the opportunity to set aside some of their earnings for retirement. [Citations omitted.] To base an IRA deduction upon contributions made with retirement pay would be inconsistent with this purpose." IRS Letter Ruling 8227053 (CCH) (April 9, 1982).

Section 219 does not consider military retirement pay as current income for reduced current services. However, this limited definition of "compensation" applies to § 219 *only*. 26 U.S.C. § 219(f)(1). As noted above, to allow an IRA deduction for contributions made with retirement pay would be inconsistent with the purpose of an IRA, regardless of whether retirement pay is "deferred compensation" or "reduced compensation for reduced current services." Additionally, compensation does not include *current income* from passive sources such as rental income, interest income, and dividend income. Mertens, § 25C.12, p. 58.

Thus, the distinction is not so much the characterization as current income or deferred compensation, but rather active versus passive activities required to earn the income.

Funding Differences

Defendants also rely on the difference in funding the military retirement system and state and local retirement systems. State and local retirement benefits are funded by employee and employer contributions. See, *e.g.*, K.S.A. 1990 Supp. 74-4919(1) (KPERS employee contribution) and K.S.A. 1990 Supp. 74-4920 (KPERS employer contribution). The employee's contribution is taxed by Kansas in the year that it is made. K.S.A. 1990 Supp. 79-32,117(b)(vi); K.S.A. 1990 Supp. 74-4919(2). Part of the state and local government retirement benefits received after retirement include previously taxed contributions.

In contrast, the military retirement system is noncontributory. Neither military personnel nor the armed forces contribute to the military retirement system. The military retirement system is funded by annual appropriations from Congress. *McCarty v. McCarty*, 453 U.S. 210, 214, 69 L. Ed. 2d 589, 101 S. Ct. 2728 (1981). All military retirement benefits received by military retirees consist of money which has never been subject to tax. The federal government's method of funding prevents Kansas from taxing a portion of the military retirement benefits before such benefits are received.

The taxpayers argue that the inconsistent taxation of state and local retirement pay and federal military retirement pay is not directly related to significant differences between the two classes. Kansas income tax exemptions are identified strictly by source under K.S.A. 1990 Supp. 79-32,117(c). If the inconsistent tax treatment were directly related to significant differences, the taxpayers claim, KITA would not base its distinctions on source but

instead would base them on: (1) retirees who completely retire versus retirees who retire from active duty only; (2) retirees who are subject to involuntary recall; (3) retirees who are subject to the Uniform Code of Military Justice; (4) retirees who are subject to post-retirement restrictions; and (5) retirees who participate in a contributory retirement program. The taxpayers rely on *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 817, 103 L. Ed. 2d 891, 109 S. Ct. 1500 (1989), which stated: "A tax exemption truly intended to account for differences in retirement benefits would not discriminate on the basis of the source of those benefits, as Michigan's statute does; rather, it would discriminate on the basis of the amount of benefits received by individual retirees."

Defendants counter this "basis of the source" argument by pointing out that the statement from *Davis* quoted above followed the *Davis* Court's rejection of Michigan's proffered rationale for its inconsistent tax treatment. Michigan contended that the inconsistent tax treatment was justified because federal civil service retirement benefits were more munificent than Michigan's state retirement benefits. Specifically, Michigan asserted that the value of federal civil service benefits was larger than the value of state retirement benefits. The *Davis* Court observed that the average federal civil servant receives a larger pension than his or her state counterpart but that there are individual instances in which the opposite holds true. *Davis*, 489 U.S. at 817.

Defendants then advance the language accompanying the quoted statement:

"A tax exemption truly intended to account for differences in retirement benefits would not discriminate on the basis of the source of those benefits, as Michigan's statute does; rather, it would discriminate on the basis of the amount of benefits received by individual retirees. *Cf. Phillips Chemical Co., supra,* at 384-385 (rejecting proffered rationale for State's unfavorable tax treatment of lessees of federal property, because *an evenhanded application of the rationale would have resulted in inclusion of some lessees of State property in the disfavored class as well).*" (Emphasis added.) *Davis,* 489 U.S. at 817.

Defendants contend that the differences between the two classes, those receiving federal military retirement benefits and those receiving state and local government retirement benefits, are common to all members of each class. Thus, an evenhanded application of the rationale for taxing all members of one class (military retirees) does not result in taxation of some members of the other class (state and local government retirees).

We agree with this interpretation of *Davis*. All persons receiving federal military retirement benefits receive current compensation while all persons receiving state and local government retirement benefits receive deferred compensation. The fact that KITA exempts federal civil service retirement benefits and federal railroad retirements benefits is further evidence that KITA taxation of federal military retirement benefits is not based on the federal government source.

Other Federal Retirees

Taxpayers also assert inconsistent tax treatment of retirement benefits of other federal retirees. For example,

federal retirement systems for members of the CIA, Foreign Service, bankruptcy judges, and United States magistrates are all contributory, yet these classes of federal retirees are subject to Kansas income tax. Similarly, retirement benefits received by retired members of the Public Health Service (PHS) and the National Oceanic and Atmospheric Administration (NOAA) are taxed under KITA. However, retirement benefits received under federal civil service retirement or by retired railroad employees are exempt. K.S.A. 1990 Supp. 79-32,117(c)(vii) and (viii). Taxpayers argue that these differences indicate no rhyme or reason for the disparate tax treatment.

Defendants assert that it is inappropriate to look at other federal retirement benefits, arguing that the justifications for taxing other federal retirement benefits do not affect whether the taxation of military retirement benefits are directly related to the differences between military retirees and state and local government retirees. The legal interests of other federal retirees are not at issue in this appeal. The justifications for taxing these federal retirement benefits should be addressed if and when they are challenged and properly before the court.

As pointed out by taxpayers, military retirement benefits are unique in comparison to other federal retirement benefits. If another class of federal retirees had exactly the same characteristics as the class of military retirees and was taxed differently, that fact would be relevant. However, absent such a circumstance, such comparisons are not helpful given the uniqueness of the military retirement system.

Finally, taxpayers argue that inconsistent tax treatment is not *justified by* significant differences between the two classes. They contend that the noncontributory funding of military retirement benefits does not justify differential tax treatment and military retirement pay cannot be characterized as reduced compensation for reduced current services to justify inconsistent taxation.

The resolution of the primary issue in this appeal depends on our agreement with, and acceptance of, the rationale of the federal cases holding that military retirement pay is reduced current compensation for reduced current services.

Several state courts have rejected the contention that military retirement pay is reduced compensation for reduced current services. These courts have held that military retirement pay is realistically viewed as deferred compensation. *In re Marriage of Fithian*, 10 Cal. 3d 592, 111 Cal. Rptr. 369, 517 P.2d 449, *cert. denied*, 419 U.S. 825 (1974); *In re Marriage of Gallo*, 752 P.2d 47, 52-54 (Colo. 1988); *In re Marriage of Howell*, 434 N.W.2d 629, 632 (Iowa 1989); *United States v. Miranda*, 581 S.W.2d 711, 711-12 (Tex. Civ. App. 1979); and *Greene v. Greene*, 751 P.2d 827, 830-31 (Utah App. 1988), *cert. denied* 765 P.2d 1278 (Utah 1988).

A state is justified in taxing reduced current compensation paid for reduced current services while not taxing deferred compensation. We agree with, and accept, the rationale of the federal cases.

The Post-*Davis* Cases

Davis has generated litigation in states which taxed federal retirement benefits while exempting state and local government benefits. See *Bohn v. Waddell*, 164 Ariz. 74, 790 P.2d 772 (T.C. 1990), *aff'd on reconsideration* 82 Ariz. Adv. Rep. 52, 807 P.2d 1 (T.C. 1991); *Pledger v. Bosnick*, ___ Ark. ___, ___ S.W.2d ___ (No. 90-39, filed June 10, 1991); *Hackman v. Director of Revenue*, 771 S.W.2d 77 (Mo. 1989), *cert. denied* 107 L. Ed. 2d 738 (1990); *Ragsdale v. Dept. of Rev.*, 11 Or. T. R. 440 (1990); *Bass v. State*, ___ S.C. ___, 395 S.E.2d 171 (1990), *vacated and remanded* ___ U.S. ___ (1991); *Harper v. Virginia Department of Taxation*, 241 Va. 232, 401 S.E.2d 868, *vacated and remanded* ___ U.S. ___, 59 U.S.L.W. 3772 (1991); *Hogan v. Musolf*, 157 Wis. 2d 362, 459 N.W.2d 865 (Ct. App. 1990), *rev'd* ___ Wis. 2d ___, ___ N.W.2d ___ (June 26, 1991).

Bohn was a suit brought by five plaintiffs – two retired United States military retirees, one United States civil service retiree, and two spouses of the military retirees. Arizona's tax scheme started with federal adjusted gross income and provided a deduction for all benefits received from Arizona state retirement systems. Only a $2,500 deduction was provided for benefits received from the United States civil service retirement system. No deduction was provided for military retirement benefits. Shortly after *Davis*, the Arizona legislature amended its income tax laws to give all state and federal pensioners a $2,500 deduction. The Arizona Tax Court in *Bohn* declared the prior Arizona tax scheme unconstitutional. The tax court stated: "The income tax treatment of state and federal pensions cannot be equal if the treatment of all federal pensions is not the same." 164 Ariz. at

82. Aside from this statement, *Bohn* provides little helpful analysis for the case at bar. There is no mention of any argument advanced by Arizona to uphold the disparate treatment of military retirees. In light of the legislative action, it appears that the Arizona legislature believed that federal civil service retirees are similarly situated to federal military retirees.

In *Hackman*, plaintiffs were a federal military retiree and his spouse. The Missouri scheme started with federal AGI. The scheme allowed deductions for retirement benefits received from state and local government retirement systems while allowing no deductions for retirement benefits from nonstate retirement plans. The court stated: "4 U.S.C. § 111 draws no distinction between federal military personnel; nor shall we draw such a distinction." 771 S.W.2d at 80. However, the Missouri Director of Revenue conceded that Missouri's taxation scheme offended 4 U.S.C. § 111 under *Davis*.

In *Ragsdale*, a federal pensioner brought the action to challenge Oregon tax laws which exempted pensions of state and local employees while taxing pensions of federal employees. The Oregon Tax Court found that Oregon's tax provisions came within the *Davis* holding. *Ragsdale* did not involve military retirees and provides little assistance on this issue.

Following *Davis*, South Carolina amended its tax laws to comply with *Davis*. *Bass*, ___ S.C. at ___, 395 S.E.2d at 172. The only issue in *Bass* was whether *Davis* should apply retrospectively.

Harper was a challenge by federal civil service retirees and federal military retirees who sought refunds

for taxes paid on the tax years of 1985-1988. The only issue before the court was whether *Davis* should apply prospectively. Virginia's General Assembly amended its tax statutes to comply with *Davis*.

Hogan was a class action brought by federal retirees following *Davis*. The Wisconsin legislature amended its tax statute to comply with *Davis* for tax years beginning in 1988. Because *Hogan* did not involve military retirees and because Wisconsin amended its statute to comply with *Davis*, *Hogan* is not helpful.

In *Pledger*, the Arkansas Supreme Court reviewed a class action certification issue. The Arkansas class certified by the lower court consisted of three groups of retired Arkansas residents from: (1) various United States civil service agencies; (2) various branches of the United States armed services; and (3) the agencies and political subdivisions of other states. A question on appeal was the propriety of including military retirees and retirees from other states in the certified class. The Arkansas Supreme Court affirmed the inclusion of both groups. The *Pledger* court relied on three of its own divorce case opinions in reasoning "that those cases which hold that military pay is actually deferred compensation or in the nature of a pension represent the better reasoned application law." Slip Op. at 10. No mention is made of *Tyler*, *McCarty*, *Cornetta*, *Tafoya*, *Costello*, or *Siverling*.

Of the post-*Davis* cases, *Bohn*, *Hackman*, and *Pledger* reasoned that civil service retirees and military retirees should be treated alike.

In our view, the district court in the case at bar was justified in relying on federal precedents.

The Kansas Constitution

Without discussion or explanation, the trial court concluded that KITA does not offend Article 11, § 2 of the Kansas Constitution. Apparently, the trial court based this holding on the same reasoning used to reject taxpayers' challenge under *Davis*.

Article 11, § 2 prohibits the State from levying or collecting income taxes based upon classifications which are arbitrary, capricious, and discriminatory. A discriminatory tax must have a reasonable relationship to the subject of the right and privilege taxed. *Hartman v. State Commission of Revenue and Taxation*, 164 Kan. 67, 77-78, 187 P.2d 939 (1947). Nothing forbids different taxation of different classes where there is a reasonable basis for differentiation. See *Missouri Pacific Railroad Co. v. McDonald*, 207 Kan. 744, 752, 486 P.2d 1347 (1971).

Taxpayers contend, as demonstrated by their arguments on intergovernmental tax immunity, that KITA artificially, unnaturally, and irrationally discriminates in favor of state and local government retirees and federal civil service retirees against federal military retirees solely on the basis of the source. Taxpayers assert that, because all such retirees belonging to the same class of public sector retirees, the unequal tax burden does not have a reasonable relation to the subject matter.

Defendants correctly point out that the standard of review under Article 11, § 2 of the Kansas Constitution is a more lenient standard than that mandated in *Davis*. Under *Davis*, the discriminatory tax must be directly related to and justified by significant differences between the classes. Under Article 11, § 2, the discriminatory tax

must bear a reasonable relationship to the subject taxed. Defendants argue that the State has a legitimate purpose in providing a orderly means whereby state and local employees may retire without hardship (to enable employees to provide for old age and to effect economy and efficiency of government affairs). A tax exemption for state and local government employees is rationally related to this purpose. Further, the State has a "rational reason" for discriminating between state and federal retirees when it seeks to advance its interest in hiring and retaining qualified employees.

We have held KITA constitutional under principles of intergovernmental tax immunity. It is constitutional under Article 11, § 2 of the Kansas Constitution. The discriminatory tax bears a reasonable relationship to the subject taxed. The tax is not arbitrary or capricious.

Having held KITA to be constitutional, we need not address the remaining issues raised by the taxpayers.

Affirmed.

McFarland and Herd, JJ., not participating.

Michael J. Malone and Dean J. Smith, District Judges assigned, participating.

APPENDIX B

IN THE DISTRICT COURT OF
SHAWNEE COUNTY, KANSAS
DIVISION FOUR

KEYTON BARKER and PAULINE BARKER, et al., Plaintiffs, and ANTHONY E. CORCORAN, et al., Intervenor/Plaintiff, vs. STATE OF KANSAS, et al., Defendants.	)	No. 89-CV-666 (CONSOLIDATED)
WILLIAM J. LOBER, JR. and MARJORIE E. LOBER, et al., Plaintiffs, vs. STATE OF KANSAS, DEPARTMENT OF REVENUE, Defendants.	)	No. 89-CV-1100

MEMORANDUM DECISION AND ORDER

This matter comes before the Court on plaintiff's motion for summary judgment on the issue of liability. The defendants have responded to plaintiffs' motion and have also moved for summary judgment on the issue of whether the defendants can be held liable under 42 U.S.C. § 1983.

All named plaintiffs served at least twenty (20) years in the United States Armed Forces which include the Army, Navy and Air Force. They have been noncommissioned and commissioned officers. All named plaintiffs are Kansas residents who have paid and continue to pay Kansas income taxes. Named plaintiffs represent a certified class of approximately 14,000 federal military retirees in the State of Kansas. *Journal Entry* at 3, para. 4 (Dec. 19, 1989).

Plaintiffs brought this action challenging the Kansas Income Tax Act (KITA) (K.S.A. § 79-3201 *et seq.*) claiming it discriminates against federal military retirees and therefore, is unconstitutional because it violates 4 U.S.C. § 111 and the Supremacy Clause of the United States Constitution, the constitutional doctrine of intergovernmental tax immunity, the Privileges and Immunities Clause of the Fourteenth Amendment, and article XI, § 2 of the Kansas Constitution. *Second Amended Petition* at 9 & 11 (Sept. 22, 1989). Plaintiffs allege defendants deprived plaintiffs of their civil rights in violation of the United States Constitution, the Fourteenth Amendment and 42 U.S.C. § 1983. *Id.* at 10.

Plaintiffs also request a refund of Kansas income taxes since 1984, with interest, which are allegedly overpayments. *Id.* at 13. Plaintiffs have preserved their right to a refund by the order of this Court which recognized that plaintiffs could not receive the relief sought from the administrative process due to the Kansas Department of Revenue's inability to declare a state statute unconstitutional. *Journal Entry* at 5-6, para. 2 & 3 (Dec. 19, 1989).

CONCLUSIONS OF LAW

Federal income tax is based upon the taxpayer's federal adjusted gross income pursuant to provisions of the Internal Revenue Code. *See* 26 U.S.C. §§ 61 to 134. Federal adjusted gross income includes federal military retired pay, federal civil service retirement pay and retirement benefits paid to the States' civil service retirees, such as retired members of the Kansas Public Employees Retirement Systems.

Kansas income tax is based upon the taxpayer's Kansas adjusted gross income. An individual's federal adjusted gross is modified pursuant to K.S.A. § 79-32,117 to calculate his Kansas adjusted gross income. To arrive at an individual's Kansas adjusted gross income, his federal adjusted gross income is reduced by the amount received from the federal civil service retirement and disability fund, amounts received by retired railroad employees as a supplemental annuity, and amounts received from the Kansas Employee Retirement Systems by retired members. K.S.A. §§ 79-32,117(c) (1989) and 74-4924 (1985). The Kansas adjusted gross income includes the amount received from military retired pay and therefore, military retirees pay taxes on military retired pay. *See* K.S.A. § 79-32,117 (1989).

Plaintiffs brought this action challenging the Kansas Income Tax Act and request tax refunds as a response to the United States Supreme Court decision in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 109 S.Ct. 1500, 103 L.Ed.2d 891 (1989). In *Davis*, the plaintiff, a retired Federal Government employee receiving federal civil service retirement benefits, challenged the Michigan state income

tax. The Michigan state income tax act taxed federal civil service retirement benefits while exempting state civil service retirement benefits. Therefore, the plaintiff claimed the Michigan income tax scheme was unconstitutional under the doctrine of intergovernmental tax immunity and 4 U.S.C. § 111.

The doctrine of intergovernmental tax immunity has its roots in *McCulloch v. Maryland*, 4 Wheat 316, 4 L.Ed. 579 (1819), which held a state could not impose a discriminatory tax on an agent of the United States and thereby, indirectly tax the Federal Government. This doctrine was more fully developed in *Helvering v. Gerhart*, 304 U.S. 405, 58 S.Ct. 969, 82 L.Ed. 1427 (1938), and in *Graves v. New York ex rel. O'Keefe*, 306 U.S. 466, 59 S.Ct. 595, 83 L.Ed. 927 (1939). In *Helvering* the Supreme Court held that the Federal Government could levy nondiscriminatory taxes on the incomes of most state employees. The Supreme Court in *Graves* held federal employees were subject to nondiscriminatory taxes levied by the States. "After *Graves*, therefore, intergovernmental tax immunity barred only those taxes that were imposed directly on one sovereign by the other or that discriminated against a sovereign or those with whom it dealt." *Davis*, 103 L.Ed.2d at 902.

The principle of allowing States to tax the Federal Government "or those with whom it dealt" as long as the tax did not discriminate against the Federal Government was codified in part by 4 U.S.C. § 111. This statute was passed between the announcements of *Helvering* and *Graves* and states in pertinent part "[t]he United States consents to the taxation of pay or compensation for personal services as [a federal employee], . . . , by a duly

constituted taxing authority having jurisdiction, *If the taxation does not discriminate* against the officer or employee *because of the source* of the pay or compensation." (Emphasis added). After determining that 4 U.S.C. § 111 applies to retired as well as current federal employees, the Supreme Court in *Davis* states "the relevant inquiry is whether the inconsistent tax treatment is directly related to and justified by 'significant differences between the two classes.' " *Davis*, 103 L.Ed.2d at 905 (citing *Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U.S. 376, 383, 80 S.Ct. 474, 4 L.Ed.2d 384 (1960)).

Michigan raised the defenses of the State's interest in attracting employees by favoring its employees through tax benefits and the fact that as a general rule Federal Government retirees receive greater retirement benefits than Michigan's civil service retirees. The Supreme Court held these differences did not prove a substantial difference between the two classes which would justify a discriminatory tax treatment. *Davis*, 103 L.Ed.2d at 905-06. There are equal protection problems with the first argument. Additionally, if Michigan wished to tax retirees receiving high retirement benefits then the State's tax would be based on amount rather than source. Therefore, the United States Supreme Court declared the Michigan income tax statute unconstitutional. *Davis*, 103 L.Ed.2d at 906.

Unfortunately the *Davis* case does not provide any further guidance on what would amount to "significant differences" which justifies different tax treatment. This Court must start with the presumption that the Kansas Income Tax Act (KITA) is constitutional. *Kansas Malpractice Victims Coalition v. Bell*, 243 Kan. 333, 340, 757 P.2d 251

(1988) (citing *Tri-State Hotel Co. v. Londerholm*, 195 Kan. 748, 408 P.2d 877 (1965)). In order to decide the issue currently before this Court, whether the KITA violates 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity, the Court must examine the military non-disability retired pay and compare it to the Kansas state employee retirement system. All branches of the Armed Forces are governed by similar provisions and therefore, for the sake of this analysis this Court will cite to the statutes which regulate the United States Army.

Title 10 of the United States Code includes several provisions which regulate Army retirees: (1) the Regular Army includes retired officers and enlisted men, 10 U.S.C. § 3075(b)(3); (2) retired officers of the Army may wear their uniform while not on active duty, 10 U.S.C. § 772(c); (3) any retired member of the Regular Army is subject to recall to active duty, 10 U.S.C. §§ 688(a) and 3504(a); (4) retired members of the Armed Forces who are entitled to pay are subject to the Uniform Code of Military Justice and court-martial jurisdiction, 10 U.S.C. §§ 802(a) and 817(a); (5) officers and enlisted men may retire after 20 years of service, *see e.g.*, 10 U.S.C. §§ 3911, 3914; (6) during their service, members of the Armed Forces do not make contributions to a retirement or pension fund from which their retired pay is later drawn, *McCarty v. McCarty*, 453 U.S. 210, 214, 101 S.Ct. 2728, 69 L.Ed.2d 589, 594 (1981); (7) military retirees may lose or have their retired military pay reduced if they become an employee of the federal civil service, 5 U.S.C. § 5532.

When considering this system of military retired pay, the United States Supreme Court concluded retired Army officers "are then by law a part of the army." *United States*

v. Tyler, 15 Otto 244, 105 U.S. 244; 26 L.Ed. 985 (1881). The Supreme Court further stated:

> It is impossible to hold that men who are by statute declared to be part of the army, who may wear its uniform, whose names shall be borne upon its register, who may be assigned by their superior officers to specified duties by detail as other officers are, . . . , are still *not* in the military service.

Tyler, 105 U.S. at 246, 26 L.Ed. at 986. (Emphasis in original).

The plaintiffs argue that *Tyler* should not bear on the outcome of this case because the decision is over one hundred years old. However, *Tyler* has never been overruled and was heavily relied upon in *McCarty v. McCarty*, 453 U.S. 210, 101 S. Ct. 2728, 69 L.Ed.2d 589 (1981). The plaintiff in *McCarty* argued his non-disability military retired pay for twenty (20) years of service in the U.S. Army should not be considered community property under California law for purposes of property distribution in his divorce proceedings. Overruling a decision by the California Court of Appeals, the United States Supreme Court agreed with the plaintiff. The Supreme Court concluded "that military retired pay is reduced compensation for reduced current services." *McCarty*, 69 L.Ed.2d at 599. The Court found the California community property law threatened grave harm to "clear and substantial" federal interests which gave the United States Supreme Court through the Supremacy Clause, U.S. Const., art. VI, cl. 2, authority to override the California law.

In contrast to the military retired pay system, the Kansas Public Employees Retirement Systems (KPERS) puts no requirements upon its retirees. The normal retirement age for a KPERS member is 65 years. K.S.A. § 74-4914(1) (Supp. 1989). Normal retirement may also occur at "age 60 with the completion of 35 years of credited service or at any age with the completion of 40 years credited service." *Id.* In order to receive any KPERS retirement benefits, the member must have worked at least 10 years and must be at least 55 years of age. K.S.A. § 74-4914(5) (Supp. 1989). If a KPERS member should opt to retire before age 65 the amount of the benefits will be lowered thereby penalizing early retirement. K.S.A. § 74-4915(2) (Supp. 1989). KPERS members pay 4% of their compensation or wage into the KPERS fund. This contribution is credited to the member's individual account with annual interest. K.S.A. § 74-4919(a) (1985). If the employer is the State of Kansas, the employer contributes 3.1% of the employee's wage to the employee's individual account. K.S.A. § 74-49205 (Supp. 1989). Other KPERS employers contribute 2% of the employee's wage. *Id.* These contributions, by the employee and employer, are made at the time of the worker's employment and are drawn from when the retirement benefits are paid out. Other than staying alive, no requirements or restrictions are placed on a retired KPERS members. *See* Kansas Public Employees Retirement Systems, K.S.A. § 74-4901 *et seq.*

After examining the military non-disability retired pay which is taxed by KITA and KPERS which is exempt from tax under KITA, this Court finds there are substantial differences between the two classes which justifies the disparate tax treatment. Therefore, this Court holds

the Kansas Income Tax Act is not unconstitutional nor in violation of 4 U.S.C. § 111. Viewed in toto the military retired system is unique to other retirement systems, especially in light of the fact that military retirees are subject to recall and during active service do not contribute to their retired pay. The absence of contribution during active service by military retirees or by their employer, the Federal Government, is consistent with the *Tyler* and *McCarty* decisions which state military retired pay is reduced compensation for reduced current services.

Plaintiffs argue that the characterization of military retired pay of *Tyler* and *McCarty* should not apply due to the enactment of the Uniform Services Former Spouses Protection Act, 10 U.S.C. § 1408 and its Kansas equivalent K.S.A. § 23-201(b). After the *McCarty* decision, Congress passed the Uniform Services Former Spouses Protection Act which permits States to treat military retired pay as marital property for purposes of marital dissolution. This enactment was a policy decision by Congress and designed to treat former spouses of military retirees more equitably. In 1987, Kansas amended its Married Persons Act to treat military retired pay as marital property for purposes of divorce, separate maintenance, and annulment. K.S.A. § 23-201 (1988). Prior to this amendment, Kansas had held that military retired pay was not marital property and was nothing more then a future stream of income which will cease at the death of the retiree. *Grant v. Grant*, 9 Kan. App. 2d 671, 676, 685 P.2d 327 (1984) (citing *Powell v. Powell*, 231 Kan. 456, 648 P.2d 218 (1982)).

This Court agrees with the defendants that while the Uniform Services Former Spouses Protection Act permitted States to treat military retired pay as marital property, it did not change the legal characterization of military retired pay for any other purpose. *See also Cornetta v. U.S.*, 851 F.2d 1372, 1382 n.3 (Fed. Cir. 1988) ("the legislation did not affect the characterization of military retired pay as reduced compensation for reduced current services"). Plaintiffs argue the Supremacy Clause applies to the case at bar and therefore, this Court must find the KITA unconstitutional under *Davis* and 4 U.S.C. § 111. Certainly the Supremacy Clause applies, however, this Court finds that due to the United States Supreme Court's characterization of military retired pay as reduced compensation for reduced current services the KITA must be found constitutional.

Plaintiffs have also brought to the attention of this Court decisions from other state courts which have addressed actions brought by military retirees resulting from the *Davis* decision. *See e.g., Hackman v. Director of Revenue*, 771 S.W.2d 77 (*cert. denied* 110 S.Ct. 718) (Mo. banc 1989); *Bohn v. Waddell*, 164 Ariz. 74, 790 P.2d 772 (1990). These decisions, which held various States taxation of military retired pay was unconstitutional, are not controlling and this court is not persuaded by them.

The Court has considered all other issues raised by the parties and finds them to be without merit.

CONCLUSION

The Court finds the Kansas Income Tax Act to be constitutional. Plaintiffs' Motion for Summary Judgment on the Question of Liability is denied.

This action does not involve a genuine issue as to any material fact and therefore, the Court grants summary judgment to the defendants on its own motion. *Phillips v. Carson*, 240 Kan. 462, syl. 3, 731 P.2d 820 (1987).

In light of the findings of the Court, defendants' request for summary judgment on the issue of whether the defendants can be held liable under 42 U.S.C. § 1983 is moot.

This Memorandum Decision and Order shall serve as the Journal entry.

Dated this 31st day of October, 1990.

/s/ Adrian J. Allen
ADRIAN J. ALLEN
JUDGE OF THE
DISTRICT COURT

APPENDIX C

EXCERPTS OF RELEVANT KANSAS STATUTES ANNOTATED

Kansas Income Tax Act

SECTION 79-3201: "The title of this act shall be 'Kansas income tax act.' "

SECTION 79-32,116: "The Kansas taxable income of an individual shall be his or her Kansas adjusted gross income less his or her Kansas deductions and Kansas personal exemptions."

SECTION 79-32,117 (Supp. 1990): "(a) The Kansas adjusted gross income of an individual means such individual's federal adjusted gross income for the taxable year, with the modifications specified in this section.

(b) There shall be added to federal adjusted gross income:

* * *

(vi) Any amount of designated employee contributions picked up by an employer pursuant to K.S.A. 12-5005, 20-2603, 74-4919 and 74-4965, and amendments to such sections.

(c) There shall be subtracted from federal adjusted gross income:

* * *

(ii) Any amounts received which are included in federal adjusted gross income but which are specifically exempt from Kansas income taxation under the laws of the state of Kansas.

* * *

(vii) Amounts received as annuities under the federal civil service retirement system, from the civil service retirement and disability fund.

(viii) Amounts received by retired railroad employees as a supplemental annuity under the provisions of 45 U.S.C. 228b(a) and 228c(a)(1) *et seq.*

(ix) Amounts received by retired employees of a city and by retired employees of any board of such city as retirement allowances pursuant to K.S.A. 13-14,106, and amendments thereto, or pursuant to any charter ordinance exempting a city from the provisions of K.S.A. 13-14,106, and amendments thereto.

* * *

(xiii) For taxable years beginning after December 31, 1989, amounts received by retired employees of a board of public utilities as pension and retirement benefits pursuant to K.S.A. 13-1246, 13-1246a and 13-1249 and amendments thereto."

Kansas Public Employees Retirement System

SECTION 74-4901: "The purpose of this act is to provide an orderly means whereby employees of the participating employers who have attained retirement age as herein set forth may be retired from active service without prejudice and without inflicting a hardship upon the employees retired and to enable such employees to accumulate reserves for themselves and their dependents to

provide for old age, death and termination of employment, and for the purpose of effecting economy and efficiency in the administration of governmental affairs."

SECTION 74-4914 (Supp. 1990): "(1) The normal retirement date for a member of the system shall be the first day of the month coinciding with or following the attainment of age 65 or, commencing July 1, 1986, age 65 or age 60 with the completion of 35 years of credited service or at any age with the completion of 40 years of credited service. In no event shall a normal retirement date for a member be before six months after the entry date of the participating employer by whom such member is employed. A member may retire on the normal retirement date or on the first day of any month thereafter upon the filing with the office of the retirement system of an application in such form and manner as the board shall prescribe. Nothing herein shall prevent any person, member or retirant from being employed, appointed or elected as an employee, appointee, officer or member of the legislature. Elected officers may retire from the system on any date on or after the attainment of the normal retirement date, but no retirement benefits payable under this act shall be paid until the member has terminated such member's office."

SECTION 74-4915 (Supp. 1990): "(1) Any member who retires on or after such member's normal retirement date shall be entitled to receive an annual retirement benefit equal to the sum obtained by adding an amount for participating service and an amount for prior service determined as provided in this section. The amount for prior service shall be equal to 1% of the member's prior service annual salary multiplied by the number of years

of prior service entitled to credit as provided in K.S.A. 74-4913 and amendments thereto, except that for members retiring or after July 1, 1981, who were last employed by a participating employer which had affiliated with the system under K.S.A. 74-4910, 74-4912, 74-4929 or 74-4991 and amendments thereto, and for the period commencing January 1, 1986, for members retiring before July 1, 1981, who were last employed by a participating employer which had affiliated with the system under K.S.A. 74-4910, 74-4912, 74-4929 or 74-4991 and amendments thereto, except that any increase in benefits under this section shall be reduced by any postretirement benefit adjustments received by such member prior to July 2, 1985, the amount for prior service shall be calculated using final average salary in lieu of prior service annual salary and, in the case of any such member who became a member under subsection (3) of K.S.A. 74-4925 and amendments thereto and for whom a final average salary cannot be otherwise determined, such member's final average salary shall be based on all service for which such member received assistance in a plan under subsection (2) of K.S.A. 74-4925 and amendments thereto as certified by such employer upon request of the board. The amount for participating service shall be equal to the total of 1.25% of the member's final average salary multiplied by the number of years of participating service prior to July 1, 1982, which are entitled to credit as provided in K.S.A. 74-4913 and amendments thereto and 1.4% of the member's final average salary multiplied by the number of years of participating service after June 30, 1982, which are entitled to credit as provided in K.S.A. 74-4913 and amendments thereto."

SECTION 74-4919h (Supp. 1990): "(1) In addition to any military service credited under the provisions of K.S.A. 74-4913 or 74-4936 and amendments thereto, or in the event that an active contributing member does not qualify for credit for military service as defined in subsection (22) of K.S.A. 74-4902 and amendments thereto, such member may purchase participating credit for periods of active service in the armed forces of the United States and for periods of service required to fulfill the requirements of section 651 of title 10, United States code, which are not otherwise creditable, which when added to any creditable military service do not exceed six years and which are not the basis for military pension rights. Such member shall be entitled to purchase one quarter of participating service credit for each year of service required to fulfill the requirements of section 651 of title 10, United States code. Such purchase shall be effected by the member submitting proof of such service acceptable to the board and electing in writing to have employee contributions as provided in K.S.A. 74-4919 and amendments thereto deducted at 8% or 12% of such member's compensation. Such deductions shall commence at the beginning of the quarter following such election and shall remain in effect until all of the full quarters of such service have been purchased."

SECTION 74-4923 (Supp. 1990): "(b) Any annuity, benefits, funds, property or rights created by, or accruing to any person under the provisions of K.S.A. 74-4901 *et seq.* or K.S.A. 74-4951 *et seq.* and any acts amendatory thereof or supplemental thereto, shall be exempt from any tax of the state of Kansas or any political subdivision or taxing

body of the state; shall not be subject to execution, garnishment or attachment, or any other process or claim whatsoever, including decrees for support, except such annuity or benefit or any accumulated contributions due and owing from the system to such person are subject to decrees for support. The Kansas public employees retirement system shall not be a party to any action under article 16 of chapter 60 of the Kansas Statutes Annotated and is subject only to orders from such actions issued by the district court of Shawnee county. The system shall satisfy its obligation by making payments otherwise due to such person in care of the clerk of the Shawnee county district court. All distributions shall be made by the clerk and the system has no further liability upon delivery of the benefit or benefits to the clerk of the district court; and shall be unassignable, except as specifically provided by this act."

SECTION 74-4925 (Supp. 1990): "(1) The state board of regents shall: (a) Assist all those members of the faculty and other persons who are employed by the state board of regents or by educational institutions under its management and who are in the unclassified service under the Kansas civil service act as provided in subsection (1)(f) of K.S.A. 75-2935 and amendments thereto, in the purchase of retirement annuities for their service rendered after December 31, 1961. . . .

* * *

(4) For the purpose of establishing a procedure whereby the state board of regents and any member of the faculty or other person described in subsection (1)(a) . . . may take advantage of section 403(a) or (b) of

the federal internal revenue code of 1986 or any other section of the federal internal revenue code of 1986 which defers or excludes amounts from inclusion of income, any member of the faculty or any other person described in subsection (1)(a) . . . may request in writing that the state board of regents reduce such person's annual salary . . . in an amount equal to not less than 5% nor more than the percentage allowed under section 403(b) of the federal internal revenue code of 1986, as designated by such member of the faculty or other person described in subsection (1)(a), of the gross amount of such annual salary. In the event of such request by a faculty member or other person who is required to make the contribution as provided in subsection (1)(b), such person shall not be required to make such contribution and the state board of regents shall provide a sum equal to the percentage amount, as prescribed by K.S.A. 1988 Supp. 74-4925e and amendments thereto, of the gross annual salary of the member of the faculty or other person and shall purchase for and on behalf of each such person whose salary has been so reduced a retirement annuity contract or contracts, the annual premiums for which shall be equal to the sum of the amount of the salary reduction of the member of the faculty or other person and the amount paid by the state board of regents."

SECTION 74-4955a (Supp. 1990): "(1) Except as provided in subsection (4), each member of the system who was appointed or employed prior to July 1, 1989, may elect to be covered by the provisions of K.S.A. 1989 Supp. 74-4957a, 74-4958a, 74-4960a, 74-4963a and 74-4964a, and amendments thereto, on the first day of the first payroll period of such member coinciding with or following the

receipt of such election in the office of the retirement system, only by filing with the board of trustees of the system prior to January 1, 1990, a written election to be covered by such provisions. Failure to file such written election shall be presumed to be an election not to be covered by such provisions. Such election, whether to become a member or not to become a member, shall be irrevocable."

SECTION 74-4957 (Supp. 1990): "(1) The normal retirement date for a member of the system who is appointed or employed prior to July 1, 1989, and who does not make an election pursuant to K.S.A. 1989 Supp. 74-4955a shall be the first day of the month coinciding with or following the attainment of age 55 and the completion of 20 years of credited service. Any member may retire on such member's normal retirement date or on the first day of any month thereafter.

* * *

(3) The provisions of subsections (1) and (2) of this section and K.S.A. 1989 Supp. 74-4955a, 74-4957a, 74-4958a, 74-4960a, 74-4963a and 74-4964a notwithstanding, the normal retirement date for any member who was, up to the entry date of such member's employer, covered by a pension system under the provisions of K.S.A 13-14a01 to 13-14a14, inclusive, or 14-10a01 to 14-10a15, inclusive, and amendments thereto, shall be the first day of the month coinciding with or following the attainment of age 50 and the completion of 25 years of credited service."

SECTION 74-4958 (Supp. 1990): "(1) Any member who retires on or after such member's normal retirement date

shall be entitled to receive an age and service retirement benefit equal to 2% of such member's final average salary multiplied by the number of years of credited service except that in no case shall such retirement benefit exceed 70% of such member's final average salary."

SECTION 74-4978g (Supp. 1990): "Any person receiving or entitled to receive a pension or any other benefit, or who will become entitled to receive a pension or any other benefit, from the state highway patrol pension fund as it existed prior to April 1, 1972, shall be entitled to receive from the Kansas police and firemen's retirement system such pension or any other benefit to the same extent and subject to the same conditions as existed on April 1, 1972 . . . . All pensions and benefits received by any person under this act are hereby made and declared exempt from any tax of the state of Kansas or any political subdivision or taxing body thereof, and shall not be subject to execution, garnishment, or attachment, or any other process or claim whatsoever."

SECTION 74-49,105: "Every retirement benefit received by any person under subsection (b) of K.S.A. 74-49,104 shall be exempt from any tax of the state of Kansas or any political subdivision or taxing body of the state; shall not be subject to execution, garnishment, attachment or any other process or claim whatsoever, including decrees for support or maintenance; and shall be unassignable."

Local Retirement Systems for Police Officers and Firemen

SECTION 12-111a: "All annuities, pensions and benefits paid, which arise from service of a policeman or

fireman, by a pension and benefit plan of a city of the first or second class under a charter ordinance related to K.S.A. 13-14-10a01 *et seq.* or K.S.A. 1410a01 *et seq.* are hereby made and declared exempt from any tax of the state of Kansas or any political subdivision or taxing body thereof and shall not be subject to execution, garnishment or attachment."

SECTION 12-5005 (Supp. 1990): "(d) Each retired member of a local police or fire pension plan who becomes a special member of the Kansas police and firemen's retirement system under this section shall be entitled to receive from the Kansas police and firemen's retirement system a pension or other benefit to the same extent and subject to the same conditions as existed under the local police and fire pension plan on the day immediately preceding the entry date of the city which is affiliating with the system with regard to all active members and retired members of the plan under K.S.A. 74-4954 and amendments thereto, except no retired special member shall be appointed in or to a position or office for which compensation is paid for service to the same state agency, or the same police or fire department of a city, township, special district or county or the same sheriff's office of a county. This subsection shall not apply to service rendered by a retiree as a juror, as a witness in any legal proceeding or action, as an election board judge or clerk or in any other office or position of a similar nature. Any retiree employed by a participating employer in the Kansas police and firemen's retirement system shall not make contributions or receive additional credit under the system for that service. This subsection, except as it relates to contributions and additional credit, shall not apply to the employment of any

retiree by the state of Kansas, or any county, city, township, special district, political subdivision or instrumentality of any one or several of the aforementioned for a period of not exceeding 30 days in any one calendar year."

(e) Every pension or other benefit received by any special member pursuant to subsection (c) or (d) is hereby made and declared exempt from any tax of the state of Kansas or any political subdivision or taxing body of this state; shall not be subject to execution, garnishment, attachment or any other process or claim whatsoever, including decrees for maintenance except such pension or benefit or any accumulated contributions due and owing from the system to such special member are subject to decrees for support."

SECTION 13-14a10: "Any annuity, benefits, funds, property, or rights created by or accruing to any person under the provisions of K.S.A. 13-14a01 *et seq.* or K.S.A. 14-10a01 *et seq.* and any acts amendatory thereof or supplemental thereto are hereby made and declared exempt from any tax of the state of Kansas or any political subdivision or taxing body thereof, and shall not be subject to execution, garnishment, or attachment, or any other process or claim whatsoever, and shall be unassignable, except as specifically provided by law."

SECTION 14-10a10: "Any annuity, benefits, funds, property, or rights created by or accruing to any person under the provisions of K.S.A. 13-14a01 *et seq.* or K.S.A. 14-10a01 *et seq.* and any acts amendatory thereof or supplemental thereto are hereby made and declared exempt from any tax of the state of Kansas or any political

subdivision or taxing body thereof, and shall not be subject to execution, garnishment, or attachment, or any other process or claim whatsoever, and shall be unassignable, except as specifically provided by law."

Retirement System for State Judges

SECTION 20-2618 (Supp. 1990): "Every annuity or other benefit received by any judge or other person pursuant to the retirement system for judges under the acts contained in article 26 of chapter 20 of the Kansas Statutes Annotated and acts amendatory thereof or supplement thereto is exempt from any tax of the state of Kansas or any political subdivision or taxing body thereof; shall not be subject to execution, garnishment, attachment or any other process or claim whatsoever, including decrees for maintenance except such annuity or other benefit or any accumulated contributions due and owing from the system to such judge are subject to decrees for support."

Retirement System for School Employees

SECTION 72-1768a: "No school annuities paid under this act [*] shall be subject to taxation under the Kansas income tax act."

SECTION 72-17,122: "Any retirement benefits paid under the provisions of this act and acts to which this act is amendatory, shall not be subject to taxation under the Kansas income tax act."

The Kansas Married Persons Act

SECTION 23-201: "(a) The property, real and personal, which any person in this state may own at the time of the person's marriage . . . shall remain the person's sole and separate property, notwithstanding the marriage, and not be subject to the disposal of the person's spouse or liable for the spouse's debts.

(b) All property owned by married persons, including the present value of any vested or unvested military retirement pay, whether described in subsection (a) or acquired by either spouse after marriage, and whether held individually or by the spouses in some form of co-ownership, such as joint tenancy or tenancy in common, shall become marital property at the time of commencement by one spouse against the other of an action in which a final decree is entered for divorce, separate maintenance, or annulment. Each spouse has a common ownership in marital property which vests at the time of commencement of such action, the extent of the vested interest to be determined and finalized by the court, pursuant to K.S.A. 60-1610 and amendments thereto.

History: G.S. 1868, ch. 62, § 1; R.S. 1923, 23-201; L. 1976, ch. 172, § 1; L. 1978, ch. 134, § 1; L. 1981, ch. 159, § 1; L. 1987, ch. 120, § 1; July 1."

EXCERPTS OF RELEVANT KANSAS ADMINISTRATIVE REGULATIONS (1989) RELATING TO THE KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

SECTION 80-3-16: "For the purposes of purchasing participating service credit under K.S.A. 1974 Supp. 74-4919h active service in the armed forces shall not include

periods of active duty for training. . . . If a member has purchased participating service credit for military service under K.S.A. 1974 Supp. 74-4919h and at the time of retirement is receiving or will become eligible to receive a military longevity pension based in part on the years of service for which participating service credit has been purchased the member shall be refunded the amount of money contributed for such purchase plus interest at a rate specified by the board and any credit granted for such service shall be forfeited. (Authorized by K.S.A. 74-4909; effective, E-74-38, July 2, 1974; effective May 1, 1975.)"

SECTION 80-5-2: "If a retirant returns to public employment, office or position as contemplated by K.S.A. 74-4914(2) for which compensation is paid, he shall receive no retirement benefits for any month during which he serves any period of time in such office except as provided in said section. (Authorized by K.S.A. 74-4909; effective Jan. 1, 1966.)"

Supreme Court, U.S.
FILED
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(3)

No. 91-611

In The

Supreme Court of the United States

October Term, 1991

KEYTON BARKER and PAULINE BARKER, et al.,

Petitioners,

vs.

STATE OF KANSAS; KANSAS DEPARTMENT OF REVENUE; SECRETARY OF REVENUE OF THE STATE OF KANSAS; and DIRECTOR OF TAXATION OF THE STATE OF KANSAS,

Respondents.

On Petition for Writ of Certiorari to the Supreme Court of Kansas

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTION PRESENTED

The Kansas Income Tax Act provides that current compensation for current services received by federal military retirees is taxable whereas deferred compensation for prior service received by retired state and local government employees is not taxable. The question presented is whether this differential tax treatment is directly related to, and justified by, significant differences between federal military retirees and retired state and local government employees and is therefore consistent with 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity.

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No. 91-611

In The

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vs.

STATE OF KANSAS; KANSAS DEPARTMENT OF REVENUE; SECRETARY OF REVENUE OF THE STATE OF KANSAS; and DIRECTOR OF TAXATION OF THE STATE OF KANSAS,

Respondents.

On Petition for Writ of Certiorari to the Supreme Court of Kansas

RESPONDENTS' BRIEF IN OPPOSITION

Respondents respectfully request that this Court deny the petition for writ of certiorari seeking review of the opinion of the Kansas Supreme Court entered on July 12, 1991.

STATEMENT OF THE CASE

The basic facts in this case are stated in the opinion below and in the petition. There are additional relevant facts which merit mention.

First, the class of taxpayers represented by petitioners consists exclusively of retired members of the United States Armed Forces. The petition devotes considerable attention to the taxation of retirement benefits received by retirees of federal agencies such as the Public Health Service, the National Oceanic and Atmospheric Administration, the Central Intelligence Agency, the Foreign Service and the federal judiciary. Pet. 16-22. The petition also refers to these retirees as "the disfavored class," "disfavored federal retirees" and "disfavored government retirees." Pet. 18-22, 26-27. However, these retirees are not parties to this action and the taxation of their retirement benefits is not at issue.

Second, all members of the class of taxpayers represented by petitioners receive nondisability military retired pay which is taxable pursuant to the provisions of the Kansas Income Tax Act. However, Kansas does not tax all military retirement benefits. Military disability pay and Veterans Administration pensions are exempt from Kansas income tax. 38 U.S.C. § 3101(a), 26 U.S.C. § 104(a), Kan. Stat. Ann. 79-32,117 (1990 Supp.). It is only the taxation of nondisability military retired pay that is at issue in this case.

REASONS FOR DENYING THE WRIT

I. THE DECISION BELOW DOES NOT PRESENT A QUESTION OF SUFFICIENT IMPORTANCE TO WARRANT REVIEW ON WRIT OF CERTIORARI.

The question presented is naturally regarded as important by the particular parties involved. However, the decision below breaks no new ground and involves nothing more than a mechanical application of the principles an-

nounced by this Court in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989), to a unique factual scenario. If this Court were to grant the petition for writ of certiorari, it could do little more than simply reiterate those same principles in the process of resolving what is essentially a parochial dispute.

Davis was a significant case and made important findings regarding the taxation of federal retirees. This case is a mere clone of *Davis*. This Court need not reexamine the issues arising in the field of intergovernmental tax immunity that were only so recently addressed. Nor does this case provide a suitable vehicle for this Court to remedy an unsettled area of the law or expand upon its previous pronouncements in a meaningful way.

Petitioners fail to cite a single state that has currently in place a statutory scheme similar to the challenged provisions of the Kansas Income Tax Act (KITA), Kan. Stat. Ann. § 79-3201 *et seq.* Accordingly, this is not a case of broad public significance and there are no "special and important reasons" why the petition for writ of certiorari should be granted. U.S. Sup. Ct. Rule 10.1.

II. THERE IS NO ACTUAL CONFLICT BETWEEN THE DECISION BELOW AND THE DECISIONS OF OTHER STATE COURTS OF LAST RESORT.

The decision below is alleged to conflict with decisions of the courts of last resort in Missouri, Arkansas and Colorado. However, even assuming there is a conflict, these three states have enacted legislation changing the manner in which they tax military retirees. Pet. 9 n.5. Similar legislation has been enacted in each of the states mentioned in the petition where issues regarding the taxation of mil-

itary retirees remain pending. *Id.* Thus, there is no "live" ongoing conflict which only this Court can resolve. Rather, the alleged conflict has already been resolved by legislative action in these other states.

The decision below does not conflict with the decision of the Missouri Supreme Court in *Hackman v. Director of Revenue*, 771 S.W.2d 77 (Mo. banc 1989), *cert. denied*, 110 S.Ct. 718 (1990). In *Hackman*, the State of Missouri conceded its method of taxing federal retirees, including military retirees, was unconstitutional. The only contested issue was whether federal retirees were entitled to receive refunds of taxes previously paid under an admittedly invalid tax scheme. The Missouri Supreme Court never considered whether the taxation of military retirement benefits was directly related to, and justified by, significant differences between military retirees and retired state and local government employees. Since the issue decided below was never considered in *Hackman* it is impossible to say that the two decisions are in conflict.

The decision below does not conflict with *Pledger v. Bosnick*, 306 Ark. 45, 811 S.W.2d 286 (1991), *petition for cert. filed*, 60 U.S.L.W. 3173 (U.S. Sept. 3, 1991) (No. 91-375), or *Kuhn v. Colorado*, ____ P.2d ____ (Nos. 90-SA-299 and 90-SA-300) (Colo. Sept. 16, 1991). The manner in which nondisability military retired pay (MRP) is taxed under the KITA is clearly distinguishable from the tax treatment of such income under the Arkansas and Colorado statutory schemes. Further, the rationale for differential tax treatment of MRP in Kansas is different than in Arkansas and Colorado.

Under the KITA, MRP is taxable whereas state and local government retirement benefits are exempt. Kan. Stat.

Ann. §§ 79-32,117 (1990 Supp.), 79-32,117(c)(ii) (1990 Supp.) and 74-4923(b) (1990 Supp.). The court below found that this differential tax treatment is justified because MRP is reduced current compensation for reduced current services while state and local government retirement benefits are deferred compensation. Pet. 30a.

The Arkansas statutes at issue in *Pledger* provided a $6,000 exemption for active duty military personnel but no corresponding exemption for current state and local government employees. Ark. Code Ann. § 26-51-306 (1987). However, state and local government retirement benefits were entirely exempt from tax while military retirees were limited to a $6,000 exemption. Ark. Code Ann. § 26-51-307 (1987). In its petition for writ of certiorari filed with this Court in *Pledger v. Bosnick*, No. 91-375, the State of Arkansas claimed its inconsistent tax treatment of MRP is justified by the favorable treatment of active duty military pay. Clearly, the Arkansas statutory scheme, and the justifications offered in support of its validity, is not comparable to the KITA and the reasoning of the court below.

The Colorado statutes at issue in *Kuhn* provided for equal tax treatment of all retirees, including military retirees, age 55 or older. Colo. Rev. Stat. § 39-22-104(4)(f) (1988 Supp.). However, military retirees under age 55 were limited to a $2,000 exemption while all other retirees received a $20,000 exemption. Colo. Rev. Stat. § 39-22-104(4)(g). The differential tax treatment of military retirees was clearly unrelated to any distinction between current compensation and deferred compensation. The only statutory basis to support different tax treatment was a retiree's age. This tax scheme, and its underlying rationale, is in no way similar to the taxation of MRP under the KITA.

Although the decision below is alleged to conflict with *Pledger* and *Kuhn*, nowhere do petitioners allege the KITA is identical, or even similar, to the statutory schemes previously in effect in Arkansas and Colorado. The facts and the law in those states are too dissimilar to conclude that the decisions are in conflict. All that can be fairly said is that each turns on its own set of circumstances when considered in light of unique statutory provisions.

These decisions do not conflict with respect to the interpretation and application of *Davis*, 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity. Neither the Kansas Supreme Court nor any other state court of last resort has stated that *Davis* was incorrectly decided. There is no dispute that military retirees are entitled to receive the protection of 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity. Further, there is no dispute that the test set out in *Davis* is applicable in determining the validity of differential state tax treatment of MRP. The only true point of conflict concerns the characterization of MRP as either current compensation for current services or deferred compensation for prior service. This is essentially a choice of law question.

Based on this Court's decisions in *United States v. Tyler*, 105 U.S. 244 (1881), and *McCarty v. McCarty*, 453 U.S. 210 (1981), the Kansas Supreme Court concluded that MRP is current compensation. [MRP is "reduced compensation for reduced, but currently rendered services." *McCarty*, 453 U.S. at 221. MRP is compensation "continued at a reduced rate and the connection (with the military service) is continued with a retirement from active service only." *Tyler*, 105 U.S. at 245.] In contrast, the courts of last resort in

Arkansas and Colorado opted to rely on state law characterizing MRP as deferred compensation or a pension.

The real question petitioners seek to have this Court decide is whether a state must ignore federal law characterizing MRP as current compensation and apply state law characterizing MRP as deferred compensation in determining the validity of a state tax alleged to violate principles of intergovernmental tax immunity. However, this Court's recent decision in *Mansell v. Mansell*, 490 U.S. 581 (1989), indicates that this question must be answered in the negative. *Mansell* stated that Congress may override the characterization of MRP as current compensation only by enacting a specific grant of authority giving states the power to treat MRP otherwise. 490 U.S. at 588. No such legislation has been enacted to permit states to deviate from the federal characterization of MRP for state income tax purposes. This Court should not grant the petition for writ of certiorari unless it intends to reconsider or overrule *Mansell*.

The other grounds of conflict alleged by petitioners are either speculative or illusory. Petitioners urge this Court to ensure the taxation of military retirees will not vary from state to state. Pet. 8. However, states clearly have the authority to either tax, or not tax, military retirees. They are prohibited only from a tax that discriminates against military retirees because of the source of their compensation. 4 U.S.C. § 111. One state may elect to tax all retirees while another state may exempt all retirees. MRP would be subject to tax in the first state but not in the second. But this would not constitute a violation of the law by either state. The alleged conflict is not one the law was designed to prohibit.

Petitioners also allege that, if allowed to stand, the decision below will encourage other states to tax military retirees. Pet. 9-10. Again, states have the authority to impose such a tax and whether a state legislature may elect to do so at some future time is irrelevant to this Court's consideration of a petition for writ of certiorari.

III. THE TAXATION OF MILITARY RETIREMENT BENEFITS UNDER THE KANSAS INCOME TAX ACT IS CONSISTENT WITH THIS COURT'S HOLDING AND RATIONALE IN *DAVIS V. MICHIGAN DEPT. OF TREASURY*, 489 U.S. 803 (1989).

The taxation of MRP under the KITA does not conflict with the narrow holding in *Davis* or the broader principles discussed therein. *Davis* involved federal civil service retirees, not military retirees. This Court held that a state is prohibited from taxing federal civil service retirement benefits if it does not also tax state and local government retirement benefits. In Kansas, both federal civil service retirement benefits and state and local government retirement benefits are exempt from tax. Kan. Stat. Ann. §§ 79-32,117(c)(vii) (1990 Supp.), 79-32,117(c)(ii) (1990 Supp.) and 79-4923(b) (1990 Supp.). Thus, the KITA does not suffer from the same infirmities that caused the Michigan tax at issue in *Davis* to be declared unconstitutional. Further, the KITA exemption for federal civil service retirement benefits is significant in determining the validity of the differential tax treatment of MRP.

The source of both federal civil service retirement benefits and MRP is the federal government. The fact that federal civil service retirement benefits are exempt while MRP is taxable belies petitioners' claim that MRP is taxable

because of its source. Since other income from the same source is exempt the basis for the taxation of MRP must rest elsewhere. As the court below stated, "[t]he fact that KITA exempts federal civil service retirement benefits and federal railroad retirement benefits is further evidence that the KITA taxation of federal military retirement benefits is not based on the federal government source." Pet. 28a.

Under *Davis*, a state tax which discriminates against federal retirees does not, in and of itself, violate 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity. Differential treatment of federal retirees and retired state and local government employees is permissible if "there are 'significant differences between the two classes' themselves." *Davis*, 489 U.S. at 816. The only prohibition is that the tax may not discriminate "because of the source of pay or compensation." 4 U.S.C. § 111.

The two classes of taxpayers considered in *Davis* were essentially alike. Where there are no significant differences between two classes of taxpayers, a discriminatory tax can only be deemed to differentiate on account of some extrinsic factor such as the source of income. It was for this reason the Michigan tax was declared unconstitutional. However, a discriminatory tax can be justified if it is based on intrinsic differences. Nothing in 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity prohibits different tax treatment of two classes of taxpayers that are inherently different.

While this Court's analysis in *Davis* disclosed no significant differences between the two classes of taxpayers, the court below identified numerous differences between military retirees and retired state and local government employees. Foremost among these is the fact that military

retirees receive reduced current compensation for reduced current services while retired state and local government employees receive deferred compensation for prior service. Pet. 30a. Consistent with this finding, this Court has stated that MRP "*differs in some significant respects* from a typical pension or retirement plan." *McCarty*, 453 U.S. at 221. (Emphasis added). Similarly, the Department of Defense has stated that, despite a superficial resemblance, "there are in fact *substantial differences* between the military retirement system and all other retirement systems." *Military Compensation Background Papers—Compensation Elements and Related Manpower Cost Items—Their Purposes and Legislative Backgrounds*, 3rd Ed. (1987) 367-368. (Emphasis added).

Respondents do not dispute the result in *Davis*. If Kansas, like Michigan, taxed federal civil service retirement benefits while exempting state and local government retirement benefits such a tax would clearly be unconstitutional. However, the facts in this case are distinguishable from those in *Davis* and compel a different result. The two decisions are not in conflict.

In *Davis*, this Court set out the test for determining the validity of a state income tax alleged to violate the doctrine of intergovernmental tax immunity. "[T]he relevant inquiry is whether the inconsistent tax treatment is *directly related to, and justified by,* 'significant differences between the two classes.' " *Davis*, 489 U.S. at 816. (Emphasis added). The court below concluded that the taxation of MRP under the KITA satisfies both prongs of the *Davis* test.

As discussed above, the Kansas Supreme Court determined the differential tax treatment at issue is "justified by" the distinction between current compensation and de-

ferred compensation. Petitioners have made no attempt to discredit the grounds relied upon in the court below. Petitioners simply ignore *Tyler* and *McCarty*. They do not suggest those decisions are distinguishable, inapplicable or should be overruled.

Instead, petitioners argue military retirees are entitled to the same tax treatment as all other federal, state and local government retirees because 4 U.S.C. § 111 does not recognize any distinction between federal officers and employees. Pet. 28. This view, however, exposes petitioners' misapprehension of the nature and purpose of 4 U.S.C. § 111. It is correct that all federal retirees, including military retirees, are entitled to the protection of 4 U.S.C. § 111. However, all federal retirees are not alike and 4 U.S.C. § 111 does not require that they all be taxed in the same manner. Had Congress intended such a result the statute would contain words to that effect. The purpose of 4 U.S.C. § 111 is to prohibit discrimination against the federal government and those with whom it deals. *Davis*, 489 U.S. at 812. (Citations omitted). This is achieved by requiring that federal retirees receive the same tax treatment as other similarly situated taxpayers, not by erecting a *per se* prohibition against nonuniform taxation of federal retirees. Since "military retirement benefits are unique in comparison to other federal retirement benefits," (Pet. 29a) there is no merit to petitioners' claim that military retirees and other federal, state and local government employees are similarly situated and that MRP is taxed solely on the basis of its federal source. In fact, the taxation of MRP is "justified by" its unique character as current compensation for current services.

This Court's analysis in *Davis* was also the basis for the conclusion in the court below that the taxation of MRP is "directly related to" significant differences between military retirees and retired state and local government employees. In *Davis*, the State of Michigan claimed the differential taxation at issue was designed to tax large pensions and exempt small pensions. However, the purported differences between the two classes of taxpayers did not hold true in all instances. Certain exempt state and local government pensions were larger than certain taxable federal pensions. Hence, the differential tax treatment was not "directly related to" the alleged differences. An "evenhanded application of the rationale" for taxing federal pensions would have resulted in the taxation of some state pensions. *Davis*, 489 U.S. at 817, citing *Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U.S. 376, 384-385 (1960).

Utilizing this same reasoning, the court below found that the differences between the two classes, those receiving federal military retirement benefits and those receiving state and local government retirement benefits, "are common to all members of each class." Thus, "an evenhanded application of the rationale" for taxing military retirees does not result in the taxation of some state and local government retirees. Pet. 28a. This analysis is consistent in every respect with this Court's analysis in *Davis*.

Petitioners allege the court below erred by failing to consider the effect of the KITA on certain federal retirees, other than military retirees, who are not parties to this action. There is nothing in *Davis* to indicate this is a proper method of analysis. This Court in *Davis* did not examine the interests and characteristics of other federal retirees to

determine the validity of the Michigan tax on federal civil service retirees. In essence, petitioners urge this Court to modify the test set out in *Davis*. This runs counter to their claim that the decision below conflicts with *Davis* and demonstrates that it is petitioners, not respondents or the court below, who would have this Court depart from its previously stated approach.

Further, since military retirees are unique in comparison to other federal retirees, the validity of the tax on MRP cannot be determined by the manner in which other federal retirement benefits are taxed. The Kansas Supreme Court rejected petitioners' bootstrap argument that military retirees are similarly situated with all other federal retirees and refused to issue an advisory opinion as to the validity of the taxation of other federal retirement benefits under the KITA. This Court should likewise refrain from addressing an issue that is beyond the scope of the pleadings and not fairly embraced in the question presented.

CONCLUSION

This Court's decision in *Davis* prompted a flood of litigation. Challenges were brought in state courts across the country to test the validity of various tax schemes providing for differential tax treatment of federal retirees. The decision below is only one such case. Having clearly articulated the legal standard for determining the validity of a state tax alleged to violate principles of intergovernmental tax immunity, this Court has fully and adequately addressed this area of the substantive law. It simply cannot review every decision in which the *Davis* test is construed and applied.

The decision below is particularly unsuitable for review on writ of certiorari in light of the narrow question presented. In the aftermath of *Davis*, most states have overlooked or ignored the taxation of military retirees. The question presented is widely regarded as unimportant and of only minor significance. The only question arising out of the *Davis* decision that remains unsettled and merits this Court's attention is whether *Davis* applies prospectively or retroactively. That question is not presented herein.

The decision below is not only correct, it is consistent in all respects with this Court's analysis in *Davis* and prior decisions of this Court stating that MRP is current compensation for current services. Any conflict with decisions of other state courts of last resort goes only to the choice of law issue and is further mitigated by the intervening legislative action in those other states and the unique manner in which each state taxes MRP. It is respectfully submitted that the petition for writ of certiorari should be denied.

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No. 91-611

In the Supreme Court of the United States

OCTOBER TERM, 1991

KEYTON E. BARKER AND PAULINE BARKER, ET AL.,
PETITIONERS

v.

STATE OF KANSAS, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF KANSAS

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Whether 4 U.S.C. 111, which codifies the constitutional doctrine of intergovernmental tax immunity, permits the State of Kansas to tax the retirement benefits of federal military retirees even though it exempts from taxation benefits paid to retired state and local employees.

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BRIEF FOR THE UNITED STATES AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

INTEREST OF THE UNITED STATES

Petitioners are representatives of a class of about 14,000 residents of the State of Kansas who have retired from service in the United States Armed Forces, and their spouses. The State of Kansas currently requires petitioners to pay taxes on the pensions they receive for their former federal military service, although it exempts from taxation pensions paid to retired employees of the State of Kansas and its political subdivisions. Because the United States has a substantial interest in ensuring that those to whom it pays pensions receive fair and equitable tax treatment from the States, the United States recently participated in a similar case, *Davis* v. *Michigan Dep't*

of the Treasury, 489 U.S. 803 (1989), in which this Court held that principles of intergovernmental tax immunity and 4 U.S.C. 111 prohibit a State from taxing the pensions of federal retirees while exempting from tax the pensions of its own retirees. The United States has a similar interest in this case involving pensions paid to retired members of the Nation's armed forces.

STATUTORY PROVISIONS INVOLVED

1. The text of 4 U.S.C. 111 is set forth in Appendix A, *infra*, 1a.

2. The text of Kan. Stat. Ann. § 79-32,117 (Supp. 1990) is set forth in Appendix B, *infra*, 2a-7a.

STATEMENT

1. Pursuant to Kan. Stat. Ann. § 79-32,117 (Supp. 1990), a taxpayer's adjusted gross income for purposes of the Kansas income tax is generally identical to that taxpayer's federal adjusted gross income (defined in 26 U.S.C. 62), increased by the items set forth in Section 32,117(b) and decreased by the items set forth in Section 32,117(c).[1] Because federal adjusted gross income includes retirement benefits without regard to source, see 26 U.S.C. 61(a)(11), all state and federal retirement benefits would be subject to taxation under this scheme unless specifically excluded by Section 32,117(c).

Pursuant to Section 32,117(c)(ii), adjusted gross income for Kansas purposes does not include amounts that "are specifically exempt from Kansas income taxation under the laws of the state of Kansas." Be-

[1] The statute also provides for certain minor modifications related to estates, trusts, and partnerships, as set forth in Section 32,117(d) and (e).

cause various provisions of Kansas statutes exempt retirement benefits paid by the State and its political subdivisions,[2] this provision effectively grants a comprehensive exemption from tax for state and local retirement benefits.[3]

By contrast, the statute offers only a narrow exclusion from adjusted gross income for two types of specifically identified federal retirement benefits, "[amounts] received as annuities under the federal civil service retirement system, from the civil service retirement and disability fund," Section 32,117(c)(vii), and "[a]mounts received by retired railroad employees as a supplemental annuity under the provisions of 45 U.S.C. 228b(a) and 228c(a)(1) *et seq.*," Section 32,117(c)(viii).[4] All other federal re-

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[2] See Kan. Stat. Ann. § 12-5005(e) (Supp. 1990), § 13-14a10, § 14-10a10 (1982) (exempting benefits paid to retired policemen and firemen under municipal retirement plans); Kan. Stat. Ann. § 20-2618 (Supp. 1990) (exempting benefits paid under a retirement system for state judges); Kan. Stat. Ann. § 72-1768a (1985) (exempting benefits paid under a retirement system for school employees); Kan. Stat. Ann. § 74-4923(b) (Supp. 1990) (exempting retirement benefits paid under the Kansas Public Employees Retirement System and Kansas Police and Fireman's Retirement System); Kan. Stat. Ann. § 74-4978g (Supp. 1990) (exempting highway patrol pension fund benefits); Kan. Stat. Ann. § 74-49,105 (1985) (exempting benefits paid under a retirement system for court reporters); Kan. Stat. Ann. § 79-32,117(c)(ix) (Supp. 1990) (exempting benefits paid to retired city employees).

[3] The opinion of the Kansas Supreme Court did not identify any type of retirement benefit paid by a Kansas government that would be subject to the Kansas income tax scheme. See Pet. App. 9a (stating that "benefits paid to * * * state, and local government retirees are exempt from Kansas income tax").

[4] The latter provision apparently refers to portions of the Railroad Retirement Act of 1974, formerly codified in those

tirement benefits are subject to tax;[5] the most common benefits subject to taxation are the federal military retirement benefits involved in this case.[6]

2. The named petitioners are representatives of a class of approximately 14,000 Kansas residents who are retired members of the United States Armed Forces (and, where applicable, their joint taxpayer spouses), all of whom were subject to Kansas income taxation on their military retirement benefits between 1984 and 1989. In 1989, petitioners filed two class actions contending that the Kansas taxation scheme violates the constitutional doctrine of intergovernmental tax immunity and 4 U.S.C. 111 because it discriminates in favor of state retirement benefits.

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sections of the United States Code. The analogous currently effective provisions are codified at 45 U.S.C. 231 *et seq.*

[5] Federal military retirees 62 years of age or older are entitled to a $120 tax credit against Kansas income tax on their retirement benefits. Kan. Stat. Ann. § 79-32,111b (1989). But this does not substantially mitigate the general decision to tax federal military retirement benefits. First, because many military personnel may retire after 20 years of service regardless of age (see, *e.g.*, 10 U.S.C. 3911 (Army), 8911 (Air Force)), many military retirees are not eligible for this credit. Moreover, under applicable Kansas tax rates this small credit is unlikely to shield the entire amount of retirement pay from state taxation. See Kan. Stat. Ann. § 79-32,110 (1989) (setting forth tax rates for Kansas income tax).

[6] In addition to federal military retirees, the Kansas system imposes an income tax on sums paid to retired justices and judges of the United States under 28 U.S.C. 371; retired bankruptcy judges and magistrates under 28 U.S.C. 377; Foreign Service retirees under the Foreign Service Retirement and Disability Fund, 22 U.S.C. 4041 *et seq.*; National Oceanic and Atmospheric Administration retirees under 33 U.S.C. 853*o*; and Public Health Service retirees under 42 U.S.C. 212.

See Pet. App. 3a-5a. The state district court rejected their claims. *Id.* at 36a-46a. In its view, federal rules that require retired military personnel to be subject to recall to active duty make pensions payable to those individuals the functional equivalent of compensation for current services. Because the Kansas scheme taxes compensation for current services, the court perceived no discrimination against federal military retirees. *Id.* at 41a-44a.

3. The Kansas Supreme Court affirmed. Pet. App. 1a-35a. Noting this Court's holding in *McCarty* v. *McCarty*, 453 U.S. 210 (1981), that a military pension was not subject to division in a divorce proceeding, as well as other decisions noting the continued benefits and burdens that former military service places on a military retiree, see Pet. App. 17a-21a, the court agreed with the district court's determination that pension benefits received by federal military retirees effectively are "reduced current compensation for reduced current services." *Id.* at 30a. In the court's view, the differences between military retirement benefits and traditional pension plans are sufficient to justify the disparate treatment. *Ibid.*

DISCUSSION

The decision of the Kansas Supreme Court misinterprets and misapplies the constitutional doctrine of intergovernmental tax immunity, as recently articulated by this Court in *Davis* v. *Michigan Dep't of the Treasury*, 489 U.S. 803 (1989), and directly conflicts with a recent decision by the highest court of Colorado, holding that a State cannot impose a tax on federal military retirement benefits unless it also imposes the same tax on state employee retirement benefits.

1. In 4 U.S.C. §111, Congress has generally consented to state taxation of its employees, subject to

the proviso at issue in this case, that "the taxation does not discriminate against the * * * employee because of the source of the pay or compensation."[7] As the *Davis* Court noted, the need to consider the interests of the federal government makes the standard for determining whether a state tax discriminates quite different from the standard under which state economic regulations are tested under the Equal Protection Clause. 489 U.S. at 816; see *Phillips Chemical Co.* v. *Dumas Independent School District*, 361 U.S. 376, 385 (1960). Under the governing principles, inconsistent tax treatment is permitted only if it "is directly related to, and justified by, 'significant differences between the two classes.'" 489 U.S. at 816 (quoting *Phillips Chemical Co.*, 361 U.S. at 383).[8]

The principal basis offered by the Kansas Supreme Court to justify the disparate tax treatment of federal military retirement benefits was the continuing effect federal law has on retired members of the

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[7] As this Court concluded in *Davis*, this nondiscrimination clause is coextensive with—and thus fully preserves—the prohibition against discriminatory taxes embodied in the constitutional doctrine of intergovernmental tax immunity. 489 U.S. at 812-813.

[8] Compare *Cleburne* v. *Cleburne Living Center, Inc.*, 473 U.S. 432, 440 (1985) (citations omitted), with regard to the Equal Protection Clause of the Fourteenth Amendment:

> The general rule is that legislation is presumed to be valid and will be sustained if the classification drawn by the statute is rationally related to a legitimate state interest. When social or economic legislation is at issue, the Equal Protection Clause allows the States wide latitude, and the Constitution presumes that even improvident decisions will eventually be rectified by the democratic processes.

Armed Forces. See Pet. App. 16a-24a.[9] To be sure, a retired officer remains a member of the Armed Forces, is still subject to the Uniform Code of Military Justice, and remains subject to recall to active duty. See *McCarty* v. *McCarty*, 453 U.S. 210, 221-222 (1981). But for several reasons these continuing effects of military service do not justify the distinctions drawn by the Kansas scheme.

First, Kansas cannot suggest that it has enacted a scheme that evenhandedly exempts all retirement benefits except for those benefits connected with sufficient ongoing obligations to justify some rational determination that the benefits are attributable in part to current services. Rather, Kansas has enacted a scheme that exempts *all* state benefits, but only certain federal benefits, identified by their source, rather than by characteristics relevant to tax policy. For example, Kan. Stat. Ann. § 20-2618 (Supp. 1990) exempts retirement benefits payable to state judges;

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[9] The Kansas Supreme Court also suggested (Pet. App. 26a) that different tax treatment might be justified by the difference in funding methods: the military retirement system is funded out of general revenues; the state and local retirement system is funded by employer and employee contributions. To the extent the suggestion relies on the federal practice of paying benefits out of general revenues rather than annual contributions, the suggestion is baseless; it is no concern of state tax policy where the federal government gets the money to pay retirement benefits. To the extent the suggestion relies on the federal practice of not requiring employee contributions, the distinction is unsupported by the facts, because Kansas law exempts all retirement benefits Kansas governmental authorities pay, even though a significant portion of those benefits is funded directly by the State. See, *e.g.*, Section 74-4920b (Supp. 1990) (discussing employer contributions to the Kansas Public Employee Retirement System).

there is no comparable exemption for benefits payable to retired federal judges under 28 U.S.C. 371(a), although federal officers retiring under that Section need provide no current services to retain their entitlement to benefits. See Pet. App. 28a-29a (summarizing similar inconsistencies).[10] The State thus cannot plausibly suggest that its scheme reflects any considered rationale other than a desire to raise as much revenue as possible without taxing pensions payable to its own employees.

These inconsistencies expose the error at the heart of the opinion of the Kansas Supreme Court: this is not a statute that treats federal military retirement benefits differently because of a reasoned conclusion that those benefits are analogous to current compensation; this is a statute that taxes federal military retirement benefits *because* they are paid by the federal, rather than the state, government. Accordingly, the Kansas income tax system violates the doctrine of intergovernmental tax immunity codified in 4 U.S.C. 111.

The rationale of the Kansas Supreme Court is undermined further by the consistent treatment under both federal and state tax law of federal retirement benefits as deferred compensation, not current compensation. For example, in federal tax law, the dis-

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[10] The Kansas Supreme Court suggested that the treatment of other federal retirees under state law is irrelevant to this case, because "[t]he legal interests of other federal retirees are not at issue in this appeal." Pet. App. 29a. We disagree. Although other federal retirees are not parties to this case, this Court's decisions make it clear that the determination of whether a state tax scheme discriminates "requires 'an examination of the whole tax structure of the state.'" *Phillips Chemical Co.*, 361 U.S. at 383 (quoting *Tradesmens Nat'l Bank* v. *Oklahoma Tax Comm'n*, 309 U.S. 560, 568 (1940)).

tinction between current compensation and deferred compensation is important under 26 U.S.C. 219, which governs the deductibility of taxpayer contributions to an individual retirement account (IRA). Pursuant to Section 219(b), the IRA deduction is limited to the amount of the taxpayer's compensation for the tax year or $2000, whichever is less. Section 219(f)(1) clarifies that the term " 'compensation' does not include any amount received as a pension or annuity and does not include any amount received as deferred compensation." It is well settled as a matter of federal law that federal military retirement benefits are excluded from the term "compensation" for purposes of this Section. See 6 M. Weinstein, *Mertens: The Law of Federal Income Taxation* § 25C.12, at 58 (1988) ("Retirement income, including federal, civil and military retirement income, is not compensation for purposes of making deductible contributions to an IRA."). As the Kansas Supreme Court acknowledged in this case, the Kansas tax scheme follows this treatment precisely, recognizing that there is no significant difference between military retirement pay and other types of retirement benefits. See Pet. App. 24a-25a.[11]

Finally, the Kansas courts erred in relying heavily on *United States* v. *Tyler*, 105 U.S. 244 (1881),

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[11] The Kansas Supreme Court attempted to justify this treatment by explaining that "this limited definition of 'compensation' applies to § 219 *only*." Pet. App. 25a. That may be, but this does not undermine the logical inference to be drawn from the definition in Section 219: the State's failure to treat military retirement pay the same way in determining the tax base as it does in more technical areas that are less likely to have a substantial effect on revenues suggests that the court's articulated rationale is not in fact the basis for the disparate treatment, but only a cloak for discrimination against federally funded benefits.

McCarty v. *McCarty*, 453 U.S. 210 (1981), *Cornetta* v. *United States*, 851 F.2d 1372 (Fed. Cir. 1988), and *Costello* v. *United States*, 587 F.2d 424 (9th Cir. 1978), cert. denied, 442 U.S. 929 (1979), because none of those cases considered the doctrine of intergovernmental tax immunity or the meaning of 4 U.S.C. 111. Rather, those cases merely described the continuing burdens associated with military retirement benefits (which we have discussed above), in the course of deciding entirely distinct legal questions.[12] Moreover, as the discussion in *McCarty* makes clear, there are significant reasons for present purposes to conclude that military retirement benefits do not differ significantly from other forms of deferred compensation:

> The amount of retired pay a service member receives is calculated not on the basis of the continuing duties he performs, but on the basis of years served on active duty and the rank obtained prior to retirement. Furthermore, should the service member actually be recalled to duty, he receives additional compensation according to the active duty pay scale, and his rate of retired pay is also increased thereafter.

453 U.S. at 223 n.16 (citation omitted).[13]

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[12] See *Tyler*, 105 U.S. at 246 (noting that a retired officer is still technically in service, in the course of holding a retired officer entitled to the benefits of a pay raise enacted after his retirement); *McCarty*, 453 U.S. at 221-222 (discussing the distinctions between military pensions and other pensions, in the course of holding that federal law prohibited a state court from dividing a military pension in a divorce proceeding); *Cornetta*, 851 F.2d at 1382-1383; *Costello*, 587 F.2d at 426.

[13] Indeed, Congress promptly overturned the holding of *McCarty* in favor of a rule subjecting military retirement

In sum, the distinct features of the military retirement benefit system do not justify the Kansas tax scheme's disparate treatment of benefits paid under that system. In the most relevant respects, military retirement benefits are much more like other retirement benefits than current wage income. Both military and civilian employees retire and receive pay only upon satisfying the statutory requirements for eligibility. Upon retirement, military personnel, like civilian employees, cease to receive their regular salary, and are entitled only to retirement pay. Finally, both military and civilian employees receive retirement benefits based upon years of past service, as opposed to post-retirement activity. See *Kuhn* v. *Colorado*, No. 90SA299 (Colo. Sept. 16, 1991), slip op. 18-19. Moreover, as we have explained, the overall structure of the Kansas tax system strongly suggests that Kansas has singled out those benefits for disparate treatment based on the source of the benefits, not on the features identified by the Kansas Supreme Court. Accordingly, we believe that the decision of the Kansas Supreme Court is incorrect.

2. The question presented warrants this Court's review. First, the decision here conflicts with that of the highest court of the State of Colorado in *Kuhn* v. *Colorado*, *supra*. In that case, the Supreme Court of Colorado considered a state tax scheme that granted a $20,000 income tax exemption for retirement benefits generally, but only a $2,000 exemption for military retirement benefits. Slip op. 6. Applying the analysis articulated by this Court in *Davis*,

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benefits to the traditional principle permitting division of retirement benefits upon divorce. See Uniformed Services Former Spouses' Protection Act, 10 U.S.C. 1408; *Mansell* v. *Mansell*, 490 U.S. 581, 584-585 (1989).

the court noted that "the overall scheme of the [military] retirement benefits is akin to a civilian pension earned by the service member for years of active service," *Kuhn*, slip op. 18, and therefore concluded that the Colorado statute discriminated against military retirement benefits by treating them differently from other retirement benefits. Slip op. 14-19. The court then rejected the justifications the State proffered to justify the discrimination, concluding that the tax scheme "was unconstitutional under the doctrine of intergovernmental tax immunity." Slip op. 20.[14]

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[14] The decision below also is contrary to the reasoning of two other state courts that have considered claims by federal military retirees against schemes that differed from the scheme at issue here by failing to exempt general federal civil service retirement benefits; in both cases the courts accepted the claims of the military retirees and invalidated the schemes in light of *Davis*. For example, in *Pledger* v. *Bosnick*, 811 S.W.2d 286 (1991), petition for cert. pending, No. 91-375, the Supreme Court of Arkansas considered a scheme that exempted all retirement income from Arkansas governmental bodies, but exempted only the first $6,000 of retirement income from all other governmental entities. See *id.* at 288. The case reached the Arkansas Supreme Court on a dispute regarding certification of the class that could challenge the statute; the court rejected claims that federal military retirees should be excluded from the class. *Id.* at 291-292.

Similarly, in *Hackman* v. *Director of Revenue*, 771 S.W.2d 77 (Mo. 1989) (en banc), cert. denied, 493 U.S. 1019 (1990), the Supreme Court of Missouri considered a scheme that, like the scheme invalidated in *Davis*, taxed federal retirement benefits but not state retirement benefits. The State argued that *Davis* was inapplicable because the claimants before the court received military retirement benefits, unlike the civil service benefits at issue in *Davis*. The Missouri court nevertheless invalidated the scheme. 771 S.W.2d at 79-80.

Second, it is clear that this is an issue of significant importance on a nationwide level. It is true that each State is free to develop its own tax programs in light of its own circumstances, and thus that issues regarding discrimination against particular types of federal benefits may differ slightly from State to State. But considering the general similarity of pension benefits throughout the Nation, and the large number of federal military retirees, there is obvious need for a clear nationwide rule regarding the circumstances under which States may subject federal military retirement benefits to tax. As the petition suggests (Pet. 9 n.5), many state legislatures responded to *Davis* by concluding, like the Colorado Supreme Court in *Kuhn*, that the Constitution requires them to provide equal treatment to *all* federal retirees, military or civilian. If the conflicting decision of the court below remains unreviewed, state legislatures will be hard-pressed to discern their constitutional obligations and, in this time of ubiquitous budgetary constraints, will have a considerable incentive to pass schemes like the one upheld by the court below, notwithstanding the doubtful force of that court's reasoning. Further confusion and disparate treatment of similarly situated retirees should be averted by this Court's resolution at this time of the conflict in decisions.[15]

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[15] We agree with petitioners' suggestion (Pet. 7-8) that the need for review by this Court is particularly significant in a case involving a constitutional challenge to a state tax system, because the Eleventh Amendment, the Tax Injunction Act, 28 U.S.C. 1341, and prudential decisions of this Court, see, *e.g.*, *Fair Assessment in Real Estate Ass'n, Inc.* v. *McNary*, 454 U.S. 100, 116 (1981), foreclose the lower federal courts as tribunals in these cases. This Court is the

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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NOVEMBER 1991

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only federal tribunal with the capacity to address the issues presented by this case.

APPENDIX A

4 U.S.C. 111. Same; taxation affecting Federal employees; income tax

The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States, a territory or possession or political subdivision thereof, the government of the District of Columbia, or an agency or instrumentality of one or more of the foregoing, by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.

APPENDIX B

Kan. Stat. Ann. § 79-32,117 (Supp. 1990). Kansas adjusted gross income of an individual.

(a) The Kansas adjusted gross income of an individual means such individual's federal adjusted gross income for the taxable year, with the modifications specified in this section.

(b) There shall be added to federal adjusted gross income:

(i) Interest income less any related expenses directly incurred in the purchase of state or political subdivision obligations, to the extent that the same is not included in federal adjusted gross income, on obligations of any state or political subdivision thereof, but to the extent that interest income on obligations of this state or a political subdivision thereof issued prior to January 1, 1988, is specifically exempt from income tax under the laws of this state authorizing the issuance of such obligations, it shall be excluded from computation of Kansas adjusted gross income whether or not included in federal adjusted gross income. Interest income on obligations of this state or a political subdivision thereof issued after December 31, 1987, shall be excluded from computation of Kansas adjusted gross income whether or not included in federal adjusted gross income.

(ii) Taxes on or measured by income or fees or payments in lieu of income taxes imposed by this state or any other taxing jurisdiction to the extent deductible in de-

termining federal adjusted gross income and not credited against federal income tax.

(iii) The federal net operating loss deduction.

(iv) Federal income tax refunds received by the taxpayer if the deduction of the taxes being refunded resulted in a tax benefit for Kansas income tax purposes during a prior taxable year. Such refunds shall be included in income in the year actually received regardless of the method of accounting used by the taxpayer. For purposes hereof, a tax benefit shall be deemed to have resulted if the amount of the tax had been deducted in determining income subject to a Kansas income tax for a prior year regardless of the rate of taxation applied in such prior year to the Kansas taxable income, but only that portion of the refund shall be included as bears the same proportion to the total refund received as the federal taxes deducted in the year to which such refund is attributable bears to the total federal income taxes paid for such year. For purposes of the foregoing sentence, federal taxes shall be considered to have been deducted only to the extent such deduction does not reduce Kansas taxable income below zero.

(v) The amount of any depreciation deduction or business expense deduction claimed on the taxpayer's federal income tax return for any capital expenditure in making any building or facility accessible to the handicapped, for which expenditure

the taxpayer claimed the credit allowed by K.S.A. 79-32,177, and amendments thereto.

(vi) Any amount of designated employee contributions picked up by an employer pursuant to K.S.A. 12-5005, 20-2603, 74-4919 and 74-4965, and amendments to such sections.

(c) There shall be subtracted from federal adjusted gross income:

(i) Interest or dividend income on obligations or securities of any authority, commission or instrumentality of the United States and its possessions less any related expense directly incurred in the purchase of such obligations or securities, to the extent included in federal adjusted gross income but exempt from state income taxes under the laws of the United States.

(ii) Any amounts received which are included in federal adjusted gross income but which are specifically exempt from Kansas income taxation under the laws of the state of Kansas.

(iii) The portion of any gain or loss from the sale or other disposition of property having a higher adjusted basis for Kansas income tax purposes than for federal income tax purposes on the date such property was sold or disposed of in a transaction in which gain or loss was recognized for purposes of federal income tax that does not exceed such difference in basis, but if a gain is considered a long-term capital gain for federal income tax purposes, the modification shall be limited to that portion of

such gain which is included in federal adjusted gross income.

(iv) The amount necessary to prevent the taxation under this act of any annuity or other amount of income or gain which was properly included in income or gain and was taxed under the laws of this state for a taxable year prior to the effective date of this act, as amended, to the taxpayer, or to a decedent by reason of whose death the taxpayer acquired the right to receive the income or gain, or to a trust or estate from which the taxpayer received the income or gain.

(v) The amount of any refund or credit for overpayment of taxes on or measured by income or fees or payments in lieu of income taxes imposed by this state, or any taxing jurisdiction, to the extent included in gross income for federal income tax purposes.

(vi) Accumulation distributions received by a taxpayer as a beneficiary of a trust to the extent that the same are included in federal adjusted gross income.

(vii) Amounts received as annuities under the federal civil service retirement system, from the civil service retirement and disability fund.

(viii) Amounts received by retired railroad employees as a supplemental annuity under the provisions of 45 U.S.C. 228b(a) and 228c(a)(1) *et seq.*

(ix) Amounts received by retired employees of a city and by retired employees of any

board of such city as retirement allowances pursuant to K.S.A. 13-14,106, and amendments thereto, or pursuant to any charter ordinance exempting a city from the provisions of K.S.A. 13-14,106, and amendments thereto.

(x) For taxable years beginning after December 31, 1976, the amount of the federal tentative jobs tax credit disallowance under the provisions of 26 U.S.C. 280 C. For taxable years ending after December 31, 1978, the amount of the targeted jobs tax credit and work incentive credit disallowances under 26 U.S.C. 280 C.

(xi) For taxable years beginning after December 31, 1986, dividend income on stock issued by Kansas Venture Capital, Inc.

(xii) For taxable years commencing after December 31, 1984, and prior to January 1, 1990, the amount of any gain realized by a mortgagor resulting from the sale or other disposition of real estate due to the foreclosure of a mortgage upon such real estate or the voluntary conveyance of mortgaged property to the mortgagee, or by a debtor resulting from the release of liability on a contract for the purchase of real estate, to the extent included in the taxpayer's adjusted gross income for federal income tax purposes. The provisions of this paragraph shall not apply to any gain realized by an investor from any such transaction concerning tax shelters which are required or would have been required to be registered with the federal Internal Revenue Service pursuant

to Section 6111 of the Internal Revenue Code, except that, the number of investors under such section shall be determined by treating all members of a family as one investor to the extent they would qualify as class A or class B distributees under K.S.A. 79-1537, and amendments thereto.

(xiii) For taxable years beginning after December 31, 1989, amounts received by retired employees of a board of public utilities as pension and retirement benefits pursuant to K.S.A. 13-1246a and 13-1249 and amendments thereto.

(d) There shall be added to or subtracted from federal adjusted gross income the taxpayer's share, as beneficiary of an estate or trust, of the Kansas fiduciary adjustment determined under K.S.A. 79-32,135, and amendments thereto.

(e) The amount of modifications required to be made under this section by a partner which relates to items of income, gain, loss, deduction or credit of a partnership shall be determined under K.S.A. 79-32,131, and amendments thereto, to the extent that such items affect federal adjusted gross income of the partner.

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

KEYTON E. BARKER and
PAULINE BARKER, *et al.*,
Petitioners,

v.

STATE OF KANSAS, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the Supreme Court of Kansas

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF *AMICUS CURIAE* ON BEHALF OF THE RETIRED OFFICERS ASSOCIATION IN SUPPORT OF PETITIONERS

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MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* ON BEHALF OF THE RETIRED OFFICERS ASSOCIATION IN SUPPORT OF PETITIONERS

Pursuant to Rule 37.2 of the Rules of this Court, *amicus* respectfully moves for leave to file the attached brief *amicus curiae* in support of the Petitioners. Petitioners have consented to the filing of the brief. The consent of the Respondents was requested but refused.

INTEREST OF *AMICUS*

Amicus is The Retired Officers Association ("TROA").[1] TROA is a nonprofit association having its principal place of business in Alexandria, Virginia. Founded in 1929, its membership now includes 374,000 members living throughout the fifty states, Puerto Rico, Guam, the Republic of the Philippines, and various foreign countries.[2] Its members include past and present, active and reserve, commissioned and warrant officers in the seven Uniformed Services of the United States. TROA is dedicated to maintaining a strong national defense and has been a major advocate on matters involving a broad spectrum of issues related to the preservation of rights and benefits earned through years of dedicated service by both active and retired military personnel.[3]

The State of Kansas and approximately twenty other states have taxed military retirement compensation while exempting from state taxation the retirement benefits of state annuitants. The question presented in this case—whether a state court may engraft an exception to the rule of nondiscrimination under the constitutional doctrine of intergovernmental tax immunity, as codified in 4 U.S.C. § 111, for retired military members—is vitally important to *amicus*. If such an exception is permitted to stand, military retirees and, indeed, military members on active duty throughout the fifty states will be at risk that rights established by Congress may be abridged by the application of conflicting state common law standards of review. Moreover, in the specific context of the

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[1] Set forth in Appendix A is a list of nineteen additional military associations who have joined with TROA in submitting this motion and accompanying brief.

[2] The interests of more than 1,000,000 retired members of the Uniformed Services of the United States are represented by the military associations who have joined in filing this motion and brief.

[3] Each of the military associations joining in this motion and brief share this common purpose.

issue involved in this case, the announcement of the decision below has caused the needless protraction of litigation in other states involving this Court's decision in the case of *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989).[4]

Amicus has supported the enactment of several measures by Congress which prohibit discrimination of the type upheld by the decision below. Thus, *amicus* has a unique perspective on the question presented by this case as well as a vital interest in its proper resolution. Accordingly, *amicus* respectfully moves for leave to file the attached brief *amicus curiae* in support of the Petitioners.

Respectfully submitted,

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[4] For example, in the wake of this Court's determination in the case of *James B. Beam Distilling Co. v. Georgia*, —— U.S. ——, 111 S.Ct. 2439 (1991), West Virginia has refunded taxes collected in violation of 4 U.S.C. § 111 to civilian federal retirees. However, it continues to litigate its ability to discriminate against military retirees. *See Brown et al. v. Mierke*, C.A. No. 90-3341, Circuit Court, Kanawha County, West Virginia. Similarly, at oral argument upon remand in the case of *Harper v. Virginia Dept. of Taxation*, 241 Va. 232, 401 S.E.2d 868, *vacated and remanded*, 111 S. Ct. 2883 (1991), *on remand* (Nos. 900770 and 900792, Va., argued September 17, 1991), the Attorney General of Virginia has raised this same issue.

QUESTION PRESENTED

Whether the Kansas Income Tax Act violates constitutional or statutory principles of intergovernmental tax immunity, as recently applied in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989), by favoring retired state and local employees over retired members of the United States armed forces.

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BRIEF *AMICUS CURIAE* ON BEHALF OF THE RETIRED OFFICERS ASSOCIATION IN SUPPORT OF PETITIONERS

INTEREST OF THE AMICUS CURIAE

The interest of the amicus is set forth in the motion accompanying this brief.

REASONS FOR GRANTING THE WRIT

The decision of the Supreme Court of Kansas presents a question of far-reaching importance: whether a state court may engraft an exception to the rule of nondiscrimination under the constitutional doctrine of intergovernmental tax immunity, as codified in 4 U.S.C. § 111,

for retired members of the armed forces? The decision of the Kansas Supreme Court that it was at liberty to use state standards of review to create an exception where Congress has declined to do so conflicts with the decisions of this Court and the will of Congress. Such a result, if permitted to stand, threatens grave harm to substantial federal interests. As this Court has recognized, matters implicating the national defense are exclusively the province of Congress.

Amicus respectfully submits that this Court should grant the petition in this case to correct the erroneous result of the court below on an issue involving the important concern of national defense. *See* U.S. Const., Art. I, § 8, Cls. 12, 13 and 14. (App. B, *infra* at 2a.)

If there should be any doubt as to the need for certiorari, *amicus* requests that the Court seek the views of the Solicitor General of the United States because of the important federal interests implicated in the decision below.

A STATE COURT IS NOT AT LIBERTY TO CREATE AN EXCEPTION WHERE CONGRESS HAS DECLINED TO DO SO.

In *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989), this Court construed the "plain language" of 4 U.S.C. § 111 and concluded that the "statute leaves no room for doubt" that federal retirement benefits "are subject to § 111." *Id.* at 807. In resolving the question of the validity of the Michigan Income Tax Act, this Court held that "the relevant inquiry is whether the inconsistent tax treatment is *directly related to*, and *justified by*, 'significant differences between the two classes.'" *Id.* at 816 (emphasis added) (citation omitted). However, in resolving the issue of whether Kansas may discriminate in favor of its own retirees and against military retirees, the Kansas Supreme Court ignored the two

pronged *Davis* test and utilized a state standard of review to uphold the Kansas scheme. *See* Petition at 9a.[1]

Neither the lower court's opinion nor the position of the State demonstrates how the differential treatment of military retirees is "based on" the alleged differences between the two classes. *See Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U.S. 376, 384 (1960); *Davis*, 489 U.S. at 816-17. The only distinguishing factor set forth in Kansas' exemption provisions is the source of the compensation. There is no evidence of any kind which establishes that the Kansas legislature intended to single out military retired pay for discrimination because of any actual or perceived differences from other forms of retirement income. To the contrary, except for the discrimination here in issue, the Kansas legislature has treated military retired pay in a manner similar to other retirement income. *See* K.S.A. 1990 Supp. 72-32, 117(a).[2]

The court below based its decision on distinctions which are legally insufficient to permit a state to discriminate against military retired pay. However, a state court is " 'not at liberty to create an exception where Congress has declined to do so' ". *Freytag v. Commissioner*, —— U.S. ——, 111 S. Ct. 2631, 2636 (1991) (citation omitted).

It is within the exclusive province of Congress to make provisions for the retirement of the officers and employees of the United States. Congress has accomplished this through the enactment of a variety of retirement plans, the provisions of which incorporate important policy and personnel decisions made by Congress.[3] *See* U.S. Const., Art. I, § 8, Cl. 18 (App. B, *infra* at 2a).

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[1] In addition, the court below ignored the fact that Kansas' scheme discriminates against all federal retirees except those receiving a civil service annuity. *See* Petition at 16, 28a-29a.

[2] The statute is set forth in the Petition at 47a.

[3] *See, e.g.*, Federal Retirement System Act of 1986, P.L. 99-335, 100 Stat. 514 (1986); Public Health Services ["PHS"] retirees paid

From time to time, these various retirement plans have been modified to reflect the considered determinations of Congress that changing personnel needs, unintended inequities, omissions, or intervening court decisions necessitate change to meet specific personnel needs of the United States. *See, e.g.*, Federal Retirement System Act of 1986, P.L. 99-335, 100 Stat. 514 (1986).[4] Whatever differences that may exist between military retired pay and other forms of governmental retirement income, exist because Congress has created them pursuant to the Constitution and in furtherance of national interests. *See* U.S. Const. Art. I, § 8, Cls. 12, 13, 14 and 18. (App. B, *infra* at 2a.) However, in the exercise of that power, Congress has not consented to the discriminatory state taxation of military retired pay.

The decision below rests on the determination of the Kansas Supreme Court that military retired pay may be taxed differently from other government retirement plans.[5] However, in reaching this conclusion, the court

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under 42 U.S.C.A. § 212 (West 1991); National Oceanic and Atmospheric Administration ["NOAA"] retirees paid under 33 U.S.C.A. § 853o (West 1986 and Supp. 1991); Foreign Service retirees paid from the Foreign Service Retirement and Disability Fund, 22 U.S.C.A. § 4041 et seq. (West 1990 and Supp. 1991); retired Justices and Judges of the United States paid under 28 U.S.C.A. § 371 (West 1968 and Supp. 1991); retired Claims Court judges paid under 28 U.S.C.A. § 178; and retired bankruptcy judges and magistrates paid under 28 U.S.C. § 377 (West Supp. 1991).

[4] *See also* Report of the National Advisory Commission on Law Enforcement, April 1990, OCG-90-2 Law Enforcement Pay, which Commission was established by the Anti-Drug Abuse Act of 1988, P.L. 100-690, 102 Stat. 4181 (1988), and charged to provide Congress with a comprehensive study of issues related to the recruitment, retention and morale of career federal law enforcement officers.

[5] The court below and the State rely upon federal cases which have treated military retired pay as "reduced pay for reduced services" for purposes of interpreting and applying certain federal statutes. However, none of those cases has characterized military

below ignored the manner in which Congress has treated military retired pay.[6] In fact, Congress has never referred to military retired pay as "reduced pay for reduced service" and has recognized military retired pay as a governmental retirement plan.[7]

Contrary to the decision below, the "relevant inquiry is whether the inconsistent *tax treatment* is directly related to and justified by, 'significant differences between [the favored class (retirees of state and local subdivisions of Kansas) and this disfavored class (military retirees of the United States)].'" *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 816 (1989) (emphasis added) (citation omitted). The purpose of the inquiry relates to the ability of a state to discriminate for purposes of taxation against employees of the federal government. Therefore, the focus of the inquiry should be upon the real differences and similarities of the two classes. Here, there are no "significant differences" that justify the discriminatory taxation of military retirees.

Congress has, for federal tax purposes, consistently treated military retired pay in the same manner as any other pension. For example, in 1956 Congress amended the Social Security Act ("SSA") and the Federal Insurance Contributions Act ("FICA") to bring military per-

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retired pay as current compensation for income tax purposes and none of those cases even suggest that Congress intended retired pay to be treated as current compensation for purposes of taxation.

[6] Indeed, it apparently was of no moment to the court below that Congress specifically provided in the Public Salary Tax Act of 1939 that the Act was to be construed by reference to the Internal Revenue Code. Sec. 206 of the Act provided that: "[t]he terms used in this Act shall have the same meaning as when used in Chapter 1 of the Internal Revenue Code."

[7] In *McCarty v. McCarty*, 453 U.S. 210, 223 n.16 (1981), this Court recognized that the military retired pay of officers is a "personal entitlement" which has characteristics of both deferred and current compensation.

sonnel under the contributory system of social security in the United States. Pub. L. No. 84-881, 70 Stat. 870 (1956). *See* 42 U.S.C.A. §§ 409(d), 410(l) and (m) (Supp. 1991); 26 U.S.C.A. §§ 3121(m) and (n) (Supp. 1990).[8] One of the primary purposes of the Social Security System is to provide benefits upon retirement when employees no longer expect to receive significant amounts of compensation for their services.[9] Congress has funded the Social Security program through FICA taxes imposed on employers and employees based upon specified percentages of "the wages (as defined in section 3121(a)) received by [an individual] with respect to employment." 26 U.S.C.A. § 3101(a) (Supp. 1990). Congress has defined the term "wages" broadly to include "all remuneration for employment" unless otherwise excluded. 26 U.S.C.A. § 3121(a) (Supp. 1990). However, in extending Social Security coverage to military personnel, Congress specified that "basic pay" for active duty service would be included in the term "wages" subject to FICA taxes,

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[8] The purpose of this legislation was to "cover military personnel into the contributory Social Security System, thereby supplementing military retirement and survivors benefits." S. Rep. No. 2380, 85th Cong., 2d Sess. 1, reprinted in 1956 U.S. Code Cong. & Admin. News 3976, 3977. For members of the federal military, "[c]ontributions and benefits [are the] same as civilian employment." House Select Comm. on Survivor Benefits, 84th Cong., 2d Sess., AN ANALYSIS OF PUBLIC LAW 881 (H.R. 7089) 5 (Comm. Print 1956). *See* Survivor Benefit Act: Hearings on H.R. 7089 Before the Senate Comm. on Finance, 84th Cong., 2d Sess. 60 (1956) (statement of Captain David L. Martineau) (regarding employee contributions, "military service personnel . . . would be treated exactly the same as any other citizen who is now covered by social security.").

[9] Participants in the Social Security System become eligible to receive old age benefits at age 62; however, the amount of benefits they otherwise would be entitled to receive are reduced if the participant receives compensation "on account of work" in excess of specified levels. Military retired pay, since it is retirement income, does not reduce social security benefits. *See* 42 U.S.C. § 403(b), (f)(5)(A) and (f)(5)(C)(i).

but specifically excluded retired pay from the meaning of "wages" subject to FICA taxes. 26 U.S.C.A. § 3121(i)(2) (Supp. 1990).

Similarly, in 1966, Congress amended the Internal Revenue Code to extend to military retirees the same tax treatment extended to civil service retirees and other retirees under qualified pensions for purposes of income, estate and gift taxation of survivor annunities. Pub. L. No. 89-365, 80 Stat. 32 (1966). The legislative history of this Act establishes that Congress determined that:

> [M]embers (or former members) of the uniformed services should be treated essentially the same as retirees under the civil service program and under other qualified pension or annuity plans. Your committee has concluded that there is *no substantial grounds* for distinguishing the *tax treatment* of the plan for the uniformed services from these other plans . . . As a result, your committee has concluded that these uniformed services retirees should be treated in the same manner as pensioners under qualified plans.

H.R. Rep. No. 1118, 89th Cong., 1st Sess. 4-5 (1965).[10]

In addition, the position of the State adopted by the court below with respect to the "Individual Retirement Account" ("IRA") is in direct conflict with Congressional enactments and the settled interpretation of the Internal

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[10] Interestingly, by virtue of Kansas' adoption of a piggyback system of state taxation, the Kansas legislature has determined for purposes of its state income tax scheme that "there is no substantial grounds for distinguishing the tax treatment of the plan for the uniformed services from these other plans." However, the decision in this case leads to the anomalous result that the Kansas legislature at the same time with respect to the very same subject of taxation supposedly reached the exactly opposite conclusion that the same plan for the uniformed services was *significantly different*. *See* K.S.A. 79-32, 117(a), Petition at 47a. *Amicus* respectfully submits that such a result is untenable.

Revenue Service ("IRS"). Congress and the IRS have treated military retired pay as a pension or deferred compensation for purposes of applying federal income tax provisions which limit the amount a taxpayer may claim as a deduction for contributions to an Individual Retirement Account ("IRA"). The deduction is limited to the lesser of $2,000 or *the amount of the taxpayer's compensation.* 26 U.S.C.A. § 219(a), (b) (Supp. 1991) (emphasis added). The IRS has determined that government retirement benefits under section 414(d), including military retired pay, are not current *compensation* within the meaning of the term as used by Congress in limiting IRA deductions:

> Section 1.219-1(c) of the Income Tax Regulations provides that the term 'compensation', for purposes of sections 219 and 220 of the Code, means wages, salaries, professional fees, or other amount derived from or received from personal services actually rendered . . . . Congress has interpreted this regulation to mean that benefits received under a pension plan or other plan of deferred compensation is not compensation for purposes of sections 219 and 220 of the Code. *See* Staff of the Joint Committee on Taxation, 97th Cong., 2d Sess., General Explanation of the Economic Recovery Tax Act of 1981 (Comm. Print December 29, 1981), page 197, n.1.
>
> This interpretation is consistent with the legislative intent behind the enactment of the tax law relating to IRAs. *The purpose of an IRA is to give employees or self-employed individuals the opportunity to set aside some of their earnings for retirement.* See S. Rep. No. 93-383, 93d Cong., 1st Sess. 131 (1973), 1974-3 C.B. Supp. 210. *To base an IRA deduction upon contributions made with retirement pay would be inconsistent with this purpose.*

Priv. Ltr. Rul. 8227053 (Apr. 9, 1982) (emphasis added). *See also* M. Weinstein, MERTENS LAW OF FEDERAL INCOME TAXATION § 25C.12 at 58 (1988).

The IRS has specifically determined in other letter rulings that the military retirement system is a *retirement plan* under section 414(d) of the Code for the benefit of its employees. *See* Priv. Ltr. Rul. 8725094 (Mar. 30, 1987); Priv. Ltr. Rul. 8007048 (Nov. 21, 1979). Congress has specifically adopted the interpretation of the IRS by amending section 219(f)(1) of the Code to exclude from the term "compensation" "any amount received as a pension or annuity [or] as deferred compensation." Technical Corrections Act of 1982, Pub. L. No. 97-448, § 103, 96 Stat. 2365, 2375 (1983).[11]

Certainly, if Congress had intended to permit individual states to discriminate against military retirees for purposes of taxation, it would not have acted to insure that military retired pay is afforded the same treatment as all other retirement benefits, including pension benefits paid by state and local subdivisions to their retirees. *See, e.g.*, 26 U.S.C. §§ 3121(a)(5)(E), (i)(2), (m) and (v)(3). Similarly, if there were truly *significant differences* between military retired pay and pensions paid by state and local subdivisions, Congress would have concluded that there were *substantial grounds* for distinguishing the tax treatment of military retired pay from other retirement plans such as those exempted by Kansas. However, as previously discussed, Congress found to the contrary. *See* H.R. Rep. No. 1118, 89th Cong., 1st Sess. 5 (1965).

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[11] The Kansas Supreme Court's attempt to distinguish the treatment of military retired pay under the Kansas' scheme for purposes of the IRA deduction is unavailing. Prior to the amendment of 219(f)(1) of the Code, the interpretation of the IRS in denying an IRA deduction for military retired pay and other governmental pension payments was premised on the recognition that such payments, including military retired pay, were from governmental plans under 26 U.S.C. § 414(d). Indeed, implicit in Kansas' piggyback system of taxation is recognition of Congress' singular classification of these plans under section 414(d), which for purposes of this case, Kansas now attempts to disavow by urging that they are *significantly different*.

Moreover, if military retired pay were *significantly different* from a governmental pension plan, it certainly would not be subject to a conversion privilege for retired military members who continue their employment with the civil service upon retirement from the military service. However, Congress has specifically recognized that the entitlement to military pay is just like the creditable federal service taken into account for the determination of any other pension benefit and has expressly provided under the authority of 5 U.S.C. § 8347 that, at the option of the retired military member, the entitlement to military retired pay may be converted to a civil service pension.[12] *See* 5 C.F.R. § 831.301.

The Court below also held that Kansas' discriminatory scheme was justified because of the noncontributory nature of the military retirement system.[13] The Court con-

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[12] In connection with the enactment of the Federal Retirement System Act of 1986, Congress specifically recognized the importance of the portability of retirement benefits upon the recruitment and retention of a motivated career work force as well as permitting midcareer mobility. *See* S. Rep. No. 99-166, 99th Cong., 1st Sess. 4-5 (1985).

[13] The decision below suggests that its holding with respect to military retired pay is also supported by the defendant's assertions that: (1) federal military retirees remain members of the armed forces of the United States after they retire from active duty; they are retired from active duty only; (2) federal military retirees are subject to the Uniform Code of Military Justice (UCMJ) and may be court-martialed for offenses committed after retirement; (3) they are subject to restrictions on civilian employment after retirement; and (4) federal military retirees are subject to involuntary recall. *Amicus* respectfully suggests that these assertions are nothing more than red herrings. Certainly, if this was the basis upon which the discrimination could be justified, the scheme would not discriminate against those persons receiving military retired pay who are not subject to one or more of the so-called alleged differences. For example, former members of the reserves who receive military retired pay under 10 U.S.C. § 1331a while in a civilian status are not subject to any of these so-called differences. Similarly, many civilian retirees of the federal government are

cluded that the "federal government's method of funding prevents Kansas from taxing a portion of the military retirement benefits before such benefits are received." Petition at 26a. However, Kansas itself does not tax, at *any* time, the contributions that state or local governmental employers make to fund a state employee's pension. Petition at 26a.[14] As this Court recognized in *Davis*, a "tax exemption truly intended to account for differences in [the funding of] retirement benefits would not discriminate on the basis of the source of those benefits, as [Kansas'] statute does; rather, it would discriminate on the basis of the amount of benefits received by individual retirees [which were previously taxed]." *Davis*, 489 U.S. at 817. Accordingly, for purposes of 4 U.S.C. § 111, it is obvious that Kansas' proffered rationale fails "because an evenhanded application of the rationale would have resulted in inclusion of some [state retirees] in the disfavored class." *Id.*[15]

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subject to perfectly analogous post-retirement restrictions, including sanctions for criminal misconduct (5 U.S.C. § 8312), restrictions on post-retirement employment (18 U.S.C. § 207) and recall (22 U.S.C. § 3948(a)). However, none of these provisions in any way diminishes the fact that the pensions paid to retirees of the federal government are deferred compensation for personal services rendered. *See* 59 Cong. Rec. 6300 (April 29, 1920) (statement of Representative Hamil: "pensions are not gratuities . . . they should be looked upon as deferred wages—as payments of wages which were not disbursed at the time they were earned.") Contrary to the assertion of the defendants below, the so-called diferences represent nothing more than a considered determination of Congress of what is in the national interest for those who pursue a career of federal service.

[14] *See also* K.S.A. §§ 74-4923(b) and 74-4925(1)(a) and (4) (Supp. 1990), which provisions are reprinted in the Petition at 51a-53a.

[15] It is ironic, indeed, that the court below justified Kansas' scheme on this basis when the Internal Revenue Service has consistently adhered to the doctrine of intergovernmental tax immunity and the provisions of the Public Salary Tax Act of 1939 by recognizing that the part of current pension payments received by state

Under the doctrine of intergovernmental tax immunity, "the State [must] treat those who deal with the Government as well as it treats those with whom it deals itself." *Phillips Chemical Co. v. Dumas Independent School District*, 361 U.S. 376, 385 (1960). Consistent with this doctrine, 4 U.S.C. § 111 prohibits the discriminatory state taxation of "salaries, retirement benefits, and other forms of compensation . . . on account of the source of the compensation." *Davis*, 489 U.S. at 810. Nothing in the doctrine of intergovernmental tax immunity or the statute differentiates between military and other federal employees. As this Court recognized in *Davis*, "[t]he danger that a State is engaging in impermissible discrimination against the Federal Government is greatest when the State acts to benefit itself and those in privity with it." *Id.* at 815 n.4. In the instant case, the Kansas Supreme Court acted impermissibly when it chose to utilize a state standard of review to measure Kansas' discriminatory scheme.

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and local retirees—which is attributable to employer contributions for years prior to 1939, is exempt from the federal income tax in accordance with the requirements of the Act. *See* Rev. Rul. 56-82, 1956-1 C.B. 59; Rev. Rul. 57-75, 1957-1 C.B. 28.

CONCLUSION

Contrary to the decisions of this Court in *Phillips* and *Davis*, the Court below utilized a state standard of review in creating a distinction without a difference so as to justify a result which violates the express will of Congress. *Amicus* respectfully urges that the petition for a writ of certiorari to the Supreme Court of the State of Kansas should be granted and that the decision below should be reversed.

Respectfully submitted,

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November 8, 1991

APPENDICES

APPENDIX A

The military associations listed below have joined with TROA in the filing of this motion and attached brief:

Air Force Association (AFA)

Association of Military Surgeons of the United States (AMSUS)

Chief Warrant and Warrant Officers Association, U.S. Coast Guard (CW&WOA)

Commissioned Officers Association of the U.S. Public Health Service (COA)

Fleet Reserve Association (FRA)

Marine Corps League (MCL)

Marine Corps Reserve Officers Association (MCROA)

National Guard Association of the U.S. (NGAUS)

National Military Family Association (NMFA)

Naval Reserve Association (NRA)

Navy League of the U.S. (NLUS)

Reserve Officers Association (ROA)

Society of Medical Consultants to the Armed Service (SMCAF)

The Jewish War Veterans of the United States of America (JWV)

The Military Chaplains Associations (MCA)

The Retired Enlisted Association (TREA)

U.S. Army Warrant Officers Association (USAWOA)

U.S. Coast Guard Enlisted Association (CGEA)

USCG Chief Petty Officers Association (CPOA)

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APPENDIX B

Article I, Sec. 8 of the United States Constitution provides in relevant part:

> The Congress shall have power
>
> * * * *
>
> To raise and support armies, but no appropriation of money to that use shall be for a longer term than two years;
>
> To provide and maintain a navy;
>
> To make rules for the government and regulation of the land and naval forces;
>
> * * * *
>
> To make all laws which shall be necessary and proper for carrying into execution the foregoing powers, and all other powers vested by this constitution in the government of the United States, or in any department or officer thereof.

Supreme Court, U.S.
FILED
JAN 10 1992
OFFICE OF THE CLERK

(5)

No. 91-611

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1991

KEYTON E. BARKER AND PAULINE BARKER, *ET AL.*,
PETITIONERS,

VS.

STATE OF KANSAS; KANSAS DEPARTMENT OF REVENUE;
SECRETARY OF REVENUE OF THE STATE OF KANSAS;
AND DIRECTOR OF TAXATION OF THE STATE OF KANSAS,
RESPONDENTS.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF KANSAS

JOINT APPENDIX

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PETITION FOR CERTIORARI FILED OCTOBER 10, 1991
CERTIORARI GRANTED NOVEMBER 27, 1991

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CHRONOLOGICAL LIST OF RELEVANT DOCKET ENTRIES

Apr. 17, 1989 - Plaintiffs' original petition [Dist. Ct. Case No. 89-CV-666] filed in the District Court of Shawnee County, Kansas (the "*Barker*" case); Plaintiffs' original petition [Dist. Ct. Case No. 89-CV-1100] filed in the District Court of Leavenworth County, Kansas (the "*Lober*" case).

Apr. 18, 1989 - Plaintiffs' first amended petition filed in *Barker*.

May 18, 1989 - Defendants' original answer filed in *Barker*.

May 19, 1989 - Defendants' original answer filed in *Lober*.

June 14, 1989 - Journal Entry filed in Dist. Ct. Case No. 89-CV-1100 changing venue of *Lober* to the District Court of Shawnee County, Kansas.

Aug. 3, 1989 - Motion of Anthony Corcoran to intervene and original petition in intervention filed in *Barker*.

Aug. 10, 1989 - Plaintiffs' motion for leave to file a second amended petition filed in *Barker*.

Aug. 29, 1989 - Journal Entry filed in Dist. Ct. Case No. 89-CV-1100 consolidating *Lober* with the *Barker* case in Division No. 4 of the District Court of Shawnee County, Kansas.

Sept. 21, 1989 - Journal Entry filed permitting *Barker* plaintiffs to file a second amended petition; Journal Entry filed permitting Anthony Corcoran to intervene in *Barker*.

Sept. 22, 1989 - Plaintiffs' second amended petition filed in *Barker*.

Sept. 28, 1989 - Plaintiffs' joint motion for class certification filed.

Oct. 24, 1989 - Plaintiffs' amended joint motion for class certification filed.

Nov. 1, 1989 - Journal Entry filed dismissing Governor Hayden as a party defendant in *Barker*.

Dec. 19, 1989 - Journal Entry filed denying Defendants' motion to dismiss and granting Plaintiffs' amended motion for class certification.

Feb. 23, 1990 - Plaintiffs' motion for summary judgment on the question of liability filed.

Oct. 31, 1990 - Memorandum Decision and Order filed denying Plaintiffs' motion for summary judgment and entering judgment in favor of Defendants; Plaintiffs' notice of appeal filed.

Nov. 19, 1990 - Order filed transferring appeal to the Kansas Supreme Court.

July 12, 1991 - Opinion and judgment of the Supreme Court of the State of Kansas filed.

IN THE DISTRICT COURT OF
SHAWNEE COUNTY, KANSAS
DIVISION 4

KEYTON BARKER and WILLIAM RICHARDS, SR.,
for themselves and all others similarly situated
Plaintiffs,

v.

STATE OF KANSAS and KANSAS
DEPARTMENT OF REVENUE
Defendants.

PETITION
[Case No. 89-CV-666]

Filed April 17, 1989

Plaintiffs Keyton Barker and Williams Richards, Sr., for themselves and all others similarly situated, hereby allege and state as follows:

1. Plaintiff Keyton Barker ("Barker") is a citizen and domiciliary of Shawnee County, Kansas. Mr. Barker is a retired Noncommissioned Officer (NCO) of the United States who served 22 creditable years in the United States Army and attained the rank/grade of Sergeant First Class (SFC)/E-7 before retiring from the active military service in February 1968. Pursuant to applicable provisions of Title 10 of the United States Code, Plaintiff Barker has been and will continue to be a recipient of federal armed forces retirement benefits based upon his rank and years of service.

2. Plaintiff William Richards, Sr. ("Richards") is a

citizen and domiciliary of Shawnee County, Kansas. Mr. Richards is a retired Commissioned Officer of the United States who served more than 27 creditable years in the United States Army and attained the rank/grade of Lieutenant Colonel (LTC)/O-5 before retiring from the active military service on July 1, 1970. Pursuant to applicable provisions of Title 10 of the United States Code, Plaintiff Richards has been and will continue to be a recipient of federal armed forces retirement benefits based upon his rank and years of service.

3. Plaintiff class sought to be certified herein consists of all retired members of the federal armed forces residing in the State of Kansas who are past, present and/or future recipients of federal retirement benefits (under applicable provisions of Title 10 of the United States Code) which have been and remain subject to state income taxation. Upon information and belief, Plaintiffs Barker and Richards allege that there are more than 10,000 members of this class.

4. Defendant State of Kansas ("State") is a duly recognized and admitted state of the Union of the United States of America and may be served with process by serving Robert T. Stephan, Attorney General of the State of Kansas, Kansas Judicial Center, 301 W. 10th Street, Topeka, Kansas 66612.

5. Defendant Kansas Department of Revenue ("Department of Revenue") is an agency and instrumentality of the State of Kansas created and existing under the authority of K.S.A. 75-5101 *et seq.* and any amendments thereto, and may be served with process by serving Ed Rolfs, Secretary of Revenue of the State of Kansas, Docking State Office Building, 915 S.W. Harrison Street, Topeka, Kansas 66612.

FACTUAL BACKGROUND

6. Pursuant to pertinent provisions of the Kansas Income Tax Act (K.S.A. 79-3201, *et seq.* and amendments thereto), Plaintiffs have been required to pay and have paid state

income taxes on their federal retirement benefits during each year from 1984 through the present.

7. At all times relevant since 1984, the Department of Revenue has collected, received and disposed of such income tax payments under the color of state law for and on behalf of the State of Kansas.

8. Pursuant to the provisions of K.S.A. 79-32,117(c)(11) and K.S.A. 74-4923(b), together with amendments thereto, all retirement benefits paid by the State under the Kansas public employees retirement system (K.S.A. 74-4901 *et seq.* and amendments thereto) and the Kansas Police and Firemen's Retirement System (K.S.A. 74-4951 *et seq.* and amendments thereto) have been specifically exempt from state income taxation during each year from at least 1984 through the present. In addition, amounts received as annuities under the federal civil service retirement system; amounts received by retired railroad employees as supplemental annuity benefits; and amounts received by retired employees of a city and by retired employees of any board of such city in accordance with K.S.A. 13-14,106 or exemptions therefrom, have been likewise exempt from state income taxation, under the provisions of K.S.A. 79-32,117(c) and amendments thereto during each year from at least 1984 through the present.

9. The retirement, pension and/or annuity benefits referenced in paragraph 8 above will remain exempt from state income taxation for the indefinite future absent a change in state law. Likewise, the federal retirement benefits received by Plaintiffs will remain subject to state income taxation for the indefinite future absent a change in state law or judicial decree.

10. Such inconsistent treatment of retirement benefits for state income tax purposes constitutes discriminatory taxation which is neither directly related to nor justified by significant differences between the classes of retirees. Consequently, state income taxation of Plaintiffs' federal retirement benefits violates

4 U.S.C. § 111 and constitutional principles of intergovernmental tax immunity as discussed and applied in *Davis v. Michigan Department of Treasury*, No. 87-1020, 57 U.S.L.W. 4389 (U.S. Sup.Ct., Mar. 28, 1989).

11. Pursuant to K.S.A. 60-223, Plaintiffs Barker and Richards seek to represent the class of all persons similarly situated which is identified and defined in Paragraph 3 above. Plaintiffs Barker and Richards are members of the proposed class; their claims are typical of the claims of all class members; and they will fairly and adequately represent and protect the interests of all class members.

12. Since Plaintiffs are informed and believe that the proposed class will consist of more than 10,000 retired members of the federal and armed forces residing in Kansas, joined of all such class members is impracticable. Moreover, questions of law and fact common to members of the class predominate over any questions affecting individual members, and a class action is superior to all other available methods for securing a fair and efficient adjudication of this controversy.

COUNT I - DEPRIVATION OF FEDERAL CIVIL RIGHTS

13. The allegations articulated in Paragraph 1 through 12 above are hereby incorporated by reference as though fully set forth herein.

14. Defendant Department of Revenue, by and through its Secretary, Director of Taxation, officers, agents and employees acting under the color of state law, has subjected Plaintiffs or caused Plaintiffs to be subjected to the deprivation of rights, privileges or immunities secured by the Constitution and laws of the United States in violation of 42 U.S.C. § 1983.

15. As a result of such deprivation of federally-protected civil rights, Plaintiffs and the class they seek to represent have suffered substantial monetary damages and will continue to

suffer such damages on a quarterly and/or annual basis absent permanent injunctive relief which prohibits the Department of Revenue (including its Secretary, Director of Taxation, agents and employees) from taking any direct or indirect action to subject Plaintiffs' federal retirement benefits to state income taxation.

COUNT II - DECLARATORY JUDGMENT

16. The allegations articulated in Paragraphs 1 through 15 above are hereby incorporated by reference as though fully set forth herein.

17. An actual case and controversy exists between the parties under the provisions of K.S.A. 60-1701 *et seq.* regarding the arbitrary and discriminatory taxation of Plaintiffs' federal retirement benefits under the Kansas Income Tax Act. Absent judicial declaration that the state income tax act is unconstitutional as applied; and that federal armed forces retirees are not exempt from paying state income tax on their federal retirement benefits, Plaintiffs and the class they seek to represent will be severely and adversely affected, and will be caused to suffer severe financial damages in the future.

COUNT III - ACCOUNTING AND REFUND OF STATE INCOME TAXES ON FEDERAL RETIREMENT BENEFITS

18. The allegations articulated in Paragraphs 1 through 17 above are hereby incorporated by reference as though fully set forth herein.

19. Defendant State has subjected Plaintiffs and the class they seek to represent to arbitrary and discriminatory income taxation of federal retirement benefits since at least 1984. At all times pertinent hereto, Defendant Department of Revenue has collected and received income tax revenues from said federal retirement benefits; and Plaintiffs, including the class they seek to represent, have paid such arbitrary and discriminatory state income

taxes on such federal retirement benefits.

20. Under the circumstances presented, Plaintiffs and the class they seek to represent are entitled to an accounting of all such discriminatory income taxes collected from 1984 through the present and to a refund, together with appropriate interest at the rate of 12% per year from the date(s) of overpayment, of all such monies.

21. While Plaintiffs acknowledge the existence of certain administrative remedies to obtain state income tax refunds, such mechanisms are plainly inadequate and recourse to such procedures would be futile under the circumstances.

22. Plaintiffs and the class they seek to represent are entitled to state income tax refunds, together with interest, in substantial amount which probably exceeds $1,000,000.00 per year for each tax year from 1984 through the present.

PRAYER FOR RELIEF

WHEREFORE, premises considered, Plaintiffs pray for the following relief:

A. That the Court determine, as soon as practicable, that this case is a proper class action; that Plaintiffs Barker and Richards are proper class representatives; and that no notice of this action need be given to members of the class represented by these named plaintiffs, all in accordance with K.S.A. 60-223;

B. That the Court issue its judicial declaration that the Kansas Income Tax Act is unconstitutional as applied to Plaintiffs' federal retirement benefits; that Defendants, under the color of state law, have wrongfully subjected Plaintiffs or caused Plaintiffs to be subjected to arbitrary and discriminatory income taxation in violation of the Constitution and laws of the United States from at least 1984 through the present; and that Plaintiffs' federal retirement benefits have been and continue to be exempt from state

income taxation under the circumstances; that Plaintiffs are not required to pay state income taxes on their federal retirement benefits in the future; and that Plaintiffs are entitled to a refund of all discriminatory state income tax revenues paid and/or collected since 1984 in connection with their federal retirement benefits, together with appropriate interest at the rate of 12% per year until paid in full;

C. That the Court enter a permanent injunction prohibiting the State of Kansas, the Department of Revenue, and all officers, agents and employees thereof from assessing and/or collecting state income taxes on Plaintiffs' federal armed forces retirement benefits;

D. That the Court order the Department of Revenue to account to Plaintiffs and the class they seek to represent for all state income tax revenues collected or received since 1984 because of the taxation of Plaintiffs' federal retirement benefits;

E. That the Court enter judgment for Plaintiffs and the class they seek to represent, and against Defendants State of Kansas and Department of Revenue, for state income tax refunds to which Plaintiffs and Plaintiff class are entitled for each tax year from 1984 through the present, together with interest, in a total amount exceeding $10,000.00; and

F. That the Court award Plaintiffs their costs, including reasonable attorney fees under 42 U.S.C. § 1988, and for such other and further relief as may be deemed just and equitable under the circumstances.

* * * * * * * *

IN THE DISTRICT COURT OF
LEAVENWORTH COUNTY, KANSAS

WILLIAM H.LOBER and MARJORIE E. LOBER, husband

and wife, EDWARD F. KELLOGG and RENATE O. KELLOGG, husband and wife, ROGER J. OLSON and NANCY W. OLSON, husband and wife, ROGER W. CLAY and BETTY J. CLAY, husband and wife, and LELAND W. KEISTER and PATRICIA K. KEISTER, husband and wife, and others similarly situated
Plaintiffs,

vs.

STATE OF KANSAS, DEPARTMENT OF REVENUE
Defendants

PETITION
[Case No. 89-CV-1100]

Filed April 17, 1989

COME NOW THE PLAINTIFFS, by and through their attorney Terence A. Lober, of counsel with Davis, Beall, McGuire & Thompson, Chartered, and for their cause of action would state and allege:

1. This is a proceeding for a preliminary and permanent injunction (a) enjoining the defendant, State of Kansas. Department of Revenue, from continuing the rule, policy, and practice of exempting from taxation all retirement benefits paid by the State or its political subdivisions, while taxing retirement benefits paid to military retirees by the Federal Government; (b) requiring defendant, State of Kansas, Department of Revenue, to refund taxes previously paid on military retirement benefits.

2. Plaintiffs bring this action as a Class Action on behalf of all military retirees or persons who have been taxed by the State of Kansas in part or in whole on military retirement benefits. Members of the class on behalf of whom plaintiffs sue are so numerous that joinder of all members is impracticable.

However, there are common questions of law and fact affecting the constitutional right of equal protection under the law for military retirees. The claims of plaintiffs are typical of the claims of the class, and plaintiffs fairly and adequately protect the interests of the class. Defendants have acted and have refused to act on grounds generally applicable to the class plaintiffs represent, thereby making appropriate final injunctive relief in favor of plaintiffs and the class. The questions of law and fact common to the members of the class predominate over any questions affecting all the individual members, and therefore, a class action is superior to other available methods for the fair and efficient adjudication of this controversy.

3. The plaintiffs in this case are military retirees or persons who have been taxed by the State of Kansas and are representative of most military retirees in the State of Kansas.

4. Defendant is the Kansas Department of Revenue, a governmental body.

5. Defendant, State of Kansas Department of Revenue, has historically levied a tax upon retirement benefits received by military retirees who claim or have claimed residency in the State of Kansas. Moreover, defendant exempts from taxation all retirement benefits paid by the State or its political subdivisions to retirees claiming residency in the State of Kansas.

6. Defendants are in violation of plaintiffs' constitutional right to equal protection under the law.

7. Defendants are in violation of 4 U.S.C. Section 111 which provides as follows:

> "The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States . . . by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the

officer or employee because of the source of the pay or compensation."

8. The subject tax imposed on plaintiffs is barred by the doctrine of intergovernmental tax immunity and is not justified by significant difference between the two classes of employees.

9. As a result of the defendant's above-stated actions, the plaintiffs are being deprived of income due them as military retirees of the U. S. Armed Forces solely because of the source of the retirement benefits. Military retirees who claim or have claimed residency in Kansas are deprived of equal protection under the law as guaranteed by the equal protection clause of the Fourteenth Amendment to the United States Constitution by the defendant. Such loss and deprivation are likely to cause plaintiffs and members of their class serious and irreparable injury and harm for which they have no claim, adequate or complete remedy to redress these wrongs other than a suit for injunctive relief. Any other remedy would be attended by such uncertainties as to deny substantial relief, and would cause plaintiffs further irreparable injury and occasion damage, vexation and inconvenience.

WHEREFORE, plaintiffs respectfully request (1) this Court enter a mandatory injunction which enjoins defendant, Kansas Department of Revenue, from making a distinction between the retirement benefits paid by the State of Kansas or its political subdivisions and those paid to military retirees by the Federal Government; (2) enjoin the defendant, Kansas Department of Revenue, from making any other distinctions which result in such inconsistent treatment of retirement benefits which are in violation of 4 U.S.C. Section 111; (3) require defendant, Kansas Department of Revenue, to compute and refund the amount of all taxes paid pursuant to said State policy on military retirement benefits. Plaintiffs further pray that the Court grant their costs, reasonable attorney fees, and such other additional or alternative relief as to the Court appears equitable and just under the circumstances.

* * * * * * *

IN THE DISTRICT COURT OF
SHAWNEE COUNTY, KANSAS
DIVISION 4

FIRST AMENDED PETITION
[Case No. 89-CV-666]

Filed April 18, 1989
[Caption Omitted in Printing]

Plaintiffs Keyton Barker and William Richards, Sr., for themselves and all others similarly situated, hereby allege and state as follows:

1. Plaintiff Keyton Barker ("Barker") is a citizen and domiciliary of Shawnee County, Kansas. Mr. Barker is a retired Noncommissioned Officer (NCO) of the United States who served 22 creditable years in the United States Army and attained the rank/grade of Sergeant First Class (SFC)/E-7 before retiring from the active military service in February 1968. Pursuant to applicable provisions of Title 10 of the United States Code, Plaintiff Barker has been and will continue to be a recipient of federal armed forces retirement benefits based upon his rank and years of service.

2. Plaintiff William Richards, Sr. ("Richards") is a citizen and domiciliary of Shawnee County, Kansas. Mr. Richards is a retired Commissioned Officer of the United States who served more than 27 creditable years in the United States Army and attained the rank/grade of Lieutenant Colonel (LTC)/O-5 before retiring from the active military service on July 1, 1970. Pursuant to applicable provisions of Title 10 of the United States Code, Plaintiff Richards has been and will continue to be a recipient of federal armed forces retirement benefits based upon his rank and years of service.

3. Plaintiff class sought to be certified herein consists of all retired members of the federal armed forces residing in the State of Kansas who are past, present and/or future recipients of federal retirement benefits (under applicable provisions of Title 10 of the United States Code) which have been and remain subject to state income taxation. Upon information and belief, Plaintiffs Barker and Richards allege that there are more than 10,000 members of this class.

4. Defendant State of Kansas ("State") is a duly recognized and admitted state of the Union of the United States of America and may be served with process by serving Robert T. Stephan, Attorney General of the State of Kansas, Kansas Judicial Center, 301 W. 10th Street, Topeka, Kansas 66612.

5. Defendant Kansas Department of Revenue ("Department of Revenue") is an agency and instrumentality of the State of Kansas created and existing under the authority of K.S.A. 75-5101 *et seq.* and any amendments thereto, and may be served with process by serving Ed Rolfs, Secretary of Revenue of the State of Kansas, Docking State Office Building, 915 S.W. Harrison Street, Topeka, Kansas 66612.

FACTUAL BACKGROUND

6. Pursuant to pertinent provisions of the Kansas Income Tax Act (K.S.A. 79-3201, *et seq.* and amendments thereto), Plaintiffs have been required to pay and have paid state income taxes on their federal retirement benefits during each year from 1984 through the present.

7. At all times relevant since 1984, the Department of Revenue has collected, received and disposed of such income tax payments under the color of state law for and on behalf of the State of Kansas.

8. Pursuant to the provisions of K.S.A. 79-32,117(c)(11) and K.S.A. 74-4923(b), together with amendments

thereto, all retirement benefits paid by the State under the Kansas public employees retirement system (K.S.A. 74-4901 *et seq.* and amendments thereto) and the Kansas Police and Firemen's Retirement System (K.S.A. 74-4951 *et seq.* and amendments thereto) have been specifically exempt from state income taxation during each year from at least 1984 through the present. In addition, amounts received as annuities under the federal civil service retirement system; amounts received by retired railroad employees as supplemental annuity benefits; and amounts received by retired employees of a city and by retired employees of any board of such city in accordance with K.S.A. 13-14,106 or exemptions therefrom, have been likewise exempt from state income taxation, under the provisions of K.S.A. 79-32,117(c) and amendments thereto, during each year from at least 1984 through the present.

9. The retirement, pension and/or annuity benefits referenced in paragraph 8 above will remain exempt from state income taxation for the indefinite future absent a change in state law. Likewise, the federal retirement benefits received by Plaintiffs will remain subject to state income taxation for the indefinite future absent a change in state law or judicial decree.

10. Such inconsistent treatment of retirement benefits for state income tax purposes constitutes discriminatory taxation which is neither directly related to nor justified by significant differences between the classes of retirees. Consequently, state income taxation of Plaintiffs' federal retirement benefits violates 4 U.S.C. § 111 and constitutional principles of intergovernmental tax immunity as discussed and applied in *Davis v. Michigan Department of Treasury*, No. 87-1020, 57 U.S.L.W. 4389 (U.S. Sup.Ct., Mar. 28, 1989).

11. Pursuant to K.S.A. 60-223, Plaintiffs Barker and Richards seek to represent the class of all persons similarly situated which is identified and defined in Paragraph 3 above. Plaintiffs Barker and Richards are members of the proposed class; their claims are typical of the claims of all class members; and

they will fairly and adequately represent and protect the interests of all class members.

12. Since Plaintiffs are informed and believe that the proposed class will consist of more than 10,000 retired members of the federal and armed forces residing in Kansas, joinder of all such class members is impracticable. Moreover, questions of law and fact common to members of the class predominate over any questions affecting individual members, and a class action is superior to all other available methods for securing a fair and efficient adjudication of this controversy.

COUNT I - DEPRIVATION OF FEDERAL CIVIL RIGHTS

13. The allegations articulated in Paragraph 1 through 12 above are hereby incorporated by reference as though fully set forth herein.

14. Defendant Department of Revenue, by and through its Secretary, Director of Taxation, officers, agents and employees acting under the color of state law, has subjected Plaintiffs or caused Plaintiffs to be subjected to the deprivation of rights, privileges or immunities secured by the Constitution and laws of the United States in violation of 42 U.S.C. § 1983.

15. As a result of such deprivation of federally-protected civil rights, Plaintiffs and the class they seek to represent have suffered substantial monetary damages and will continue to suffer such damages on a quarterly and/or annual basis absent permanent injunctive relief which prohibits the Department of Revenue (including its Secretary, Director of Taxation, agents and employees) from taking any direct or indirect action to subject Plaintiffs' federal retirement benefits to state income taxation.

COUNT II - DEPRIVATION OF STATE CONSTITUTIONAL RIGHTS

16. The allegations articulated in Paragraphs 1 through

15 above are hereby incorporated by reference as though fully set forth herein.

17. The Constitution of the State of Kansas, Article 11, Section 2 implicitly prohibits Defendants from levying and collecting taxes on income based upon arbitrary, capricious and discriminatory classifications.

18. Under the circumstances described herein, Plaintiffs allege that state income taxation of their federal retirement benefits, including the levying and collection of such taxes, subjects them to unequal treatment and is impermissibly based upon arbitrary, capricious and discriminatory classifications in violation of KAN. CONST., art. 11 § 2.

COUNT III - DECLARATORY JUDGMENT

19. The allegations articulated in Paragraphs 1 through 18 above are hereby incorporated by reference as though fully set forth herein.

20. An actual case and controversy exists between the parties under the provisions of K.S.A. 60-1701 *et seq.* regarding the arbitrary and discriminatory taxation of Plaintiffs' federal retirement benefits under the Kansas Income Tax Act. Absent judicial declaration that the state income tax act is unconstitutional as applied and that federal armed forces retirees are exempt from paying state income tax on their federal retirement benefits, Plaintiffs and the class they seek to represent will be severely and adversely affected, and will be caused to suffer severe financial damages in the future.

COUNT IV - ACCOUNTING AND REFUND OF STATE INCOME TAXES ON FEDERAL RETIREMENT BENEFITS

21. The allegations articulated in Paragraphs 1 through 20 above are hereby incorporated by reference as though fully set

forth herein.

22. Defendant State has subjected Plaintiffs and the class they seek to represent to arbitrary and discriminatory income taxation of federal retirement benefits since at least 1984. At all times pertinent hereto, Defendant Department of Revenue has collected and received income tax revenues from said federal retirement benefits; and Plaintiffs, including the class they seek to represent, have paid such arbitrary and discriminatory state income taxes on such federal retirement benefits.

23. Under the circumstances presented, Plaintiffs and the class they seek to represent are entitled to an accounting of all such discriminatory income taxes collected from 1984 through the present and to a refund, together with appropriate interest at the rate of 12% per year from the date(s) of overpayment, of all such monies.

24. While Plaintiffs acknowledge the existence of certain administrative remedies to obtain state income tax refunds, such mechanisms are plainly inadequate and recourse to such procedures would be futile under the circumstances.

25. Plaintiffs and the class they seek to represent are entitled to state income tax refunds, together with interest, in substantial amount which probably exceeds $1,000,000.00 per year for each tax year from 1984 through the present.

PRAYER FOR RELIEF

WHEREFORE, premises considered, Plaintiffs pray for the following relief:

A. That the Court determine, as soon as practicable, that this case is a proper class action; that Plaintiffs Barker and Richards are proper class representatives; and that no notice of this action need be given to members of the class represented by these named plaintiffs, all in accordance with K.S.A. 60-223;

B. That the Court issue its judicial declaration that the Kansas Income Tax Act is unconstitutional as applied to Plaintiffs' federal retirement benefits; that Defendants, under the color of state law, have wrongfully subjected Plaintiffs or caused Plaintiffs to be subjected to arbitrary and discriminatory income taxation in violation of the Constitution and laws of the United States from at least 1984 through the present; and that Plaintiffs' federal retirement benefits have been and continue to be exempt from state income taxation under the circumstances; that Plaintiffs are not required to pay state income taxes on their federal retirement benefits in the future; and that Plaintiffs are entitled to a refund of all discriminatory state income tax revenues paid and/or collected since 1984 in connection with their federal retirement benefits, together with appropriate interest at the rate of 12% per year until paid in full;

C. That the Court enter a permanent injunction prohibiting the State of Kansas, the Department of Revenue, and all officers, agents and employees thereof from levying, assessing and/or collecting state income taxes on Plaintiffs' federal armed forces retirement benefits;

D. That the Court order the Department of Revenue to account to Plaintiffs and the class they seek to represent for all state income tax revenues collected or received since 1984 because of the taxation of Plaintiffs' federal retirement benefits;

E. That the Court enter judgment for Plaintiffs and the class they seek to represent, and against Defendants State of Kansas and Department of Revenue, for state income tax refunds to which Plaintiffs and Plaintiff class are entitled for each tax year from 1984 through the present, together with interest, in a total amount exceeding $10,000.00; and

F. That the Court award Plaintiffs their costs, including reasonable attorney fees under 42 U.S.C. § 1988, and such other and further relief as may be deemed just and equitable under the circumstances.

* * * * * * * *

IN THE DISTRICT COURT OF
SHAWNEE COUNTY, KANSAS
Division 4

ANSWER
[Case No. 89-CV-666]

Filed May 18, 1989
[Caption Omitted in Printing]

COMES NOW the defendants, State of Kansas and Kansas Department of Revenue, and for their answer to plaintiffs' first amended petition state and allege as follows:

1. All statements and allegations contained in plaintiffs' first amended petition not specifically admitted herein are denied.

2. Defendants are without knowledge sufficient to form a belief as to the truth of the allegations contained in paragraphs 1, 2 and 3 and therefore deny the same.

3. Paragraph 4 is admitted.

4. Defendants admit that portion of paragraph 5 stating that the Kansas Department of Revenue is an agency and instrumentality of the state of Kansas but deny that the Department of Revenue may be served with process by serving Ed Rolfs, Secretary of Revenue.

5. Defendants are without knowledge sufficient to form a belief as to the truth of the allegations contained in paragraphs 6 and 7 and therefore deny the same.

6. With respect to the allegations contained in

paragraph 8 defendants state that the statutes mentioned therein speak for themselves.

7. With respect to the allegations contained in paragraph 9 defendants admit that state statutes will continue in effect until they are lawfully changed. Defendants are without knowledge sufficient to form a belief as to the truth of the allegations concerning the federal retirement benefits allegedly received by plaintiffs and therefore deny the same.

8. Defendants deny the allegations contained in paragraph 10 and further deny that the Kansas income tax act violates the Constitution and laws of the United States and judicial doctrines of intergovernmental immunity.

9. Defendants are without knowledge sufficient to form a belief as to the truth of the allegations contained in paragraphs 11 and 12 and therefore deny the same.

10. Defendants deny the allegations contained in paragraph 14 and further deny that they have in any way deprived plaintiffs and the member of their purported class of rights, privileges and immunities secured to them under the Constitution and laws of the United States or have engaged in any conduct that would constitute a violation of 42 U.S.C. § 1983.

11. Defendants deny the allegations contained in paragraph 15 and further deny that they have in any way violated plaintiffs' civil rights. The extent, if any, of plaintiffs' alleged injuries or damages is unknown to defendants and the same are therefore denied. Defendants further deny that they should be restrained or enjoined, permanently or otherwise, from taking any action with respect to plaintiffs and the members of their purported class.

12. With respect to the allegations contained in paragraph 17 defendants state that the section of the Constitution of the state of Kansas mentioned therein speaks for itself.

13. Defendants deny the allegations contained in paragraph 18 and further deny that their treatment of plaintiffs in any way violates the Constitution of the state of Kansas.

14. Defendants deny the allegations contained in paragraph 20 and further deny they have subjected plaintiffs to arbitrary and discriminatory taxation and that the Kansas income tax act or any portion thereof is unconstitutional or otherwise invalid.

15. Defendants deny the allegations contained in paragraph 22 and further deny that they have subjected plaintiffs and the members of their purported class to arbitrary and discriminatory taxation. Defendants are without knowledge sufficient to form a belief as to the truth of the allegations that plaintiffs and the member of their purported class paid Kansas income tax during the years in question and reported federal retirement benefits as Kansas taxable income and therefore deny the same.

16. Defendants deny the allegations contained in paragraph 23 and further deny that Kansas income taxes have been unlawfully collected from plaintiffs and the members of their purported class.

17. Defendants deny the allegations contained in paragraph 24 and further deny that the existing administrative remedies available to plaintiffs are inadequate and that recourse thereto would be futile. Defendants affirmatively state and allege that plaintiffs must pursue and exhaust the administrative remedies provided by law before they may seek or obtain judicial relief.

18. Defendants deny the allegations contained in paragraph 25 and further deny that plaintiffs and the members of their purported class are entitled to refunds of Kansas income taxes paid in any of the years in question.

WHEREFORE, having fully answered plaintiffs' first

amended petition defendants pray that plaintiffs take naught thereby, that judgment be entered for defendants, that plaintiffs' petition be dismissed with prejudice and that all costs accruing herein be assessed against plaintiffs.

Defendants further pray that no class be certified for purposes of class action litigation, that no declaratory judgment be entered determining that the Kansas income tax act is unconstitutional or in any way violative of state or federal law, that no injunction be issued enjoining defendants from engaging in any conduct whatsoever and that the court grant defendants such other and further relief as it deems just and appropriate.

* * * * * * * *

IN THE DISTRICT COURT OF
LEAVENWORTH COUNTY, KANSAS

ANSWER
[Case No. 89-CV-1100]

Filed May 19, 1989
[Caption Omitted in Printing]

COMES NOW the defendants, State of Kansas and Kansas Department of Revenue, and for their answer to plaintiff's petition state and allege as follows:

1. All statements and allegations contained in plaintiffs' petition not specifically admitted herein are denied.

2. Defendants deny the allegations contained in paragraph 1 and deny that they should be restrained or enjoined, permanently or otherwise, from taking any action with respect to plaintiffs and the members of their purported class. Defendants further deny that they should be required to refund any taxes previously paid by plaintiffs and the members of their purported class.

3. Defendants are without knowledge sufficient to form a belief as to the truth of the allegations contained in paragraphs 2 and 3 and therefore deny the same.

4. Paragraph 4 is admitted.

5. Defendants admit that part of paragraph 5 stating that retirement benefits paid by the state of Kansas are exempt from Kansas income tax. The remainder of paragraph 5 is denied.

6. Defendants deny the allegations contained in paragraph 6 and further deny that they have in any way violated plaintiffs' constitutional right to equal protection of law.

7. Defendants deny the allegations contained in paragraph 7 and further deny that they have in any way violated 4 U.S.C. § 111.

8. Defendants deny the allegations contained in paragraph 8 and further deny that their conduct in any way violates or is barred by the doctrine of intergovernmental tax immunity or is otherwise not justified, unlawful or invalid.

9. Defendants deny the allegations contained paragraph 9 and deny that their actions have caused plaintiffs to be deprived of income to which they are lawfully entitled. Defendants further deny that they have deprived plaintiffs of equal protection of law and that any such alleged denial has caused irreparable harm or injury. Defendants further deny that plaintiffs have no adequate or complete remedy to redress their alleged injuries other than a suit for injunctive relief. Defendants affirmatively state and allege that plaintiffs must pursue and exhaust the administrative remedies provided by law before they may seek or obtain judicial relief.

WHEREFORE, having fully answered plaintiffs' petition defendants pray that plaintiffs take naught thereby, that judgment be entered for defendants, that plaintiffs' petition be dismissed with

prejudice and that all costs accruing herein be assessed against plaintiffs.

Defendants further pray that no injunction be issued enjoining defendants from engaging in any conduct whatsoever, that no order be entered directing defendants to refund any taxes and that the court grant defendants such other and further relief as it deems just and equitable.

* * * * * * *

IN THE DISTRICT COURT OF
SHAWNEE COUNTY, KANSAS
DIVISION 4

MOTION OF APPLICANT ANTHONY E. CORCORAN TO INTERVENE
[Case No. 89-CV-666]

Filed August 1, 1989
[Caption Omitted in Printing]

COMES NOW the applicant, Anthony E. Corcoran, and pursuant to K.S.A. §60-224(b), hereby moves the Court for its Order allowing intervention. As grounds for this motion, Anthony E. Corcoran states as follows:

1. K.S.A. §60-224(b) provides in pertinent part:

> Upon timely application anyone may be permitted to intervene in an action . . . (2) when an applicant's claim or defense and the main action have a question of law or fact in common. In exercising its discretion, the Court shall consider whether the intervention will unduly delay or prejudice the adjudication of the rights of the original parties.

2. Applicant Anthony E. Corcoran is a resident of the State of Kansas. His address is 1522 South Oak, Ottawa, Kansas 66607.

3. Applicant Corcoran is a retired federal military naval commander who now receives pension payments which are allegedly subject to Kansas State taxation in violation of federal and state law.

4. Applicant Corcoran may be a putative class member in the above captioned cause and as such may be a plaintiff whose interest is directly affected by the litigation. However, as of this date, no class has been certified in this case.

5. Pursuant to K.S.A. §60-224(c), applicant Corcoran herewith files his pleading setting forth the claim for which intervention is sought. As fully set out in the pleading, applicant Corcoran is representative of a class more broadly defined than the putative class currently before the Court. Applicant Corcoran also names Ed Rolfs, Secretary of Revenue, and John Luttjohann, Director of Taxation, as individual defendants in their official capacity, pursuant to K.S.A. §60-219 and §60-220 which govern joinder. Further, applicant Corcoran, as a class representative, will exhaust his administrative remedies on behalf of the class if the Court so orders.

6. Applicant Corcoran further requests that the Court consider his Memorandum in Support of Plaintiffs' Response to Defendants' Motion to Dismiss, filed concurrently herewith. This memorandum includes additional evidence germane to the "exhaustion of administrative remedies" argument presently pending before the Court. In the alternative, this Memorandum sets forth applicant Corcoran's willingness to exhaust administrative remedies on behalf of the class upon class certification by the Court and the Court's Order directing immediate recognition by the Department of Revenue, pursuant to K.S.A. §60-223.

All of the above is more fully set forth in the Memorandum in Support of Applicant's Motion to Intervene, Petition of Intervenor, pursuant to K.S.A. §60-224(c), and Intervenor's Memorandum in Support of Plaintiffs' Response to Defendants' Motion to Dismiss filed concurrently herewith.

WHEREFORE, applicant Corcoran respectfully requests that the Court enter its Order as follows:

a. Allowing applicant Corcoran to intervene in this action as class representative of the class defined as follows:

> All retired members of the federal armed forces or said members' survivors and beneficiaries who are past, present and/or future recipients of federal retirement benefits which have been and/or remain subject to state income taxation from the year 1984 through the present time.

b. Denying defendants' pending Motion to Dismiss or, in the alternative, certifying the class described above and allowing applicant Corcoran to proceed as class representative in collectively exhausting administrative remedies, under the Court's supervision.

* * * * * * * *

IN THE DISTRICT COURT OF
SHAWNEE COUNTY, KANSAS
DIVISION 4

PETITION OF INTERVENOR ANTHONY E. CORCORAN
[Case No. 89-CV-666]

Filed August 1, 1989
[Caption Omitted in Printing]

Intervenor Anthony E. Corcoran, for himself and all others similarly situated, hereby alleges and states as follows:

PARTIES

1. Intervenor Anthony E. Corcoran is a citizen and domiciliary of Ottawa, Kansas. Mr. Corcoran is a retired Commander of the United States Navy who served twenty creditable years in the United States Navy before retiring from the active military service in 1985. Pursuant to applicable provisions of Title 10 of the United States Code, Intervenor Corcoran has been and will continue to be a recipient of federal armed forces retirement benefits based upon his rank and years of service.

2. As more fully set out below at paragraphs 8 through 13, Intervenor/Plaintiff class sought to be certified herein consists of the following members:

> All retired members of the federal armed forces or said members' survivors and beneficiaries who are past, present and/or future recipients of federal retirement benefits (under applicable provisions of Title 10 of the United States Code) which have been and/or remain subject to state income taxation in the State of Kansas for the tax year 1984 through the present time.

3. While Intervenor/Plaintiffs acknowledge the existence of certain administrative remedies to obtain state income tax refunds, such mechanisms are plainly inadequate and recourse to such procedures would be futile under the circumstances. In the alternative, Intervenor Corcoran is willing to exhaust administrative remedies on behalf of the class under the Court's Supervision.

4. Defendant State of Kansas ("State") is a duly recognized and admitted state of the Union of the United States of America and has been served with process by the plaintiffs.

5. Defendant Kansas Department of Revenue ("Department of Revenue") is an agency and instrumentality of the State of Kansas created and existing under the authority of K.S.A. 75-5101 *et seq.* and any amendments thereto, and has been served with process by the plaintiffs.

6. Defendant Ed Rolfs is Secretary of Revenue of the State of Kansas and may be served with process at the Department of Revenue, Docking State Office Building, 915 S.W. Harrison Street, Topeka, Kansas 66612.

7. Defendant John Luttjohann is Director of Taxation for the State of Kansas and may be served with process at the Department of Revenue, Docking State Office Building, 915 S.W. Harrison Street, Topeka, Kansas 66612.

CLASS ALLEGATIONS

8. Intervenor/Plaintiffs bring this action on behalf of themselves and, pursuant to K.S.A. 60-223, on behalf of all other retired members of the federal armed services or their survivors and beneficiaries as described in paragraph 2 above.

9. Members of the Class are so numerous and geographically dispersed that joinder of all class members is impracticable. As reported in the *Topeka Capital Journal*, June 20, 1989, page 1-A, Mark Burghart, Chief Counsel for the Department of Revenue, told the Kansas legislature Interim Committee on Assessment and Taxation that there are about 14,000 military retirees in Kansas paying about $7.5 million a year in state income taxes.

10. Intervenor/Plaintiffs will fairly and adequately protect the interests of the members of the class and have retained

counsel competent and experienced in class and tax litigation.

11. Intervenor/Plaintiffs' claims are typical of the claims of the members of the class as intervenor and all members of the class were wrongfully subjected to state income taxation by defendants as fully set out below.

12. A class action is superior to other available methods for the fair and efficient adjudication of this controversy since joinder of all members is impracticable. Furthermore, as the damages suffered by individual class members may be relatively small, the expense and burden of individual litigation make it impossible for the class members to individually redress the wrongs done to them. There will be no difficulty in the management of this action as a class action.

13. There are questions of law and fact common to this class which predominate over any questions solely affecting individual members of the class. Among the questions of law and fact common to this case are:

(a) Is the State of Kansas wrongfully taxing the retirement benefits of federal military retirees or their survivors and beneficiaries.

(b) Are Intervenor/Plaintiffs recipients of benefits provided by 10 U.S.C., *et seq.*

FACTUAL BACKGROUND

14. Intervenor/Plaintiffs incorporate by reference, as though fully set forth herein, the allegations of plaintiffs Keyton Barker and William Richards, et al., contained in the Factual Background of the *Barker and Richards* Amended Petition.

COUNT I - DEPRIVATION OF FEDERAL CIVIL RIGHTS AGAINST ALL DEFENDANTS

15. Intervenor/Plaintiffs incorporate by reference, as though fully set forth herein, the allegations contained in Count I of the *Barker and Richards* Amended Petition.

COUNT II - DEPRIVATION OF STATE CONSTITUTIONAL RIGHTS AGAINST ALL DEFENDANTS

16. Intervenor/Plaintiffs incorporate by reference, as though fully set forth herein, the allegations contained in Count II of the *Barker and Richards* Amended Petition.

COUNT III - DECLARATORY JUDGMENT AGAINST ALL DEFENDANTS

17. Intervenor/Plaintiffs incorporate by reference, as though fully set forth herein, the allegations contained in Count III of the *Barker and Richards* Amended Petition.

COUNT IV - ACCOUNTING AND REFUND OF STATE INCOME TAXES ON FEDERAL RETIREMENT BENEFITS AGAINST ALL DEFENDANTS

18. Intervenor/Plaintiffs incorporate by reference, as though fully set forth herein, the allegations contained in Count IV of the *Barker and Richards* Amended Petition.

PRAYER FOR RELIEF

WHEREFORE, premises considered, Intervenor/plaintiffs pray for the following relief:

A. That the Court determine, as soon as practicable, that this case is a proper class action and that Intervenor Corcoran is a proper class representative.

B. That the Court issue its judicial declaration that the Kansas Income Tax Act is unconstitutional as applied to

intervenor/plaintiffs' federal retirement benefits; that defendants, under the color of state law, have wrongfully subjected intervenor/plaintiffs or caused intervenor/plaintiffs to be subjected to arbitrary and discriminatory income taxation in violation of the Constitution and laws of the United States from at least 1984 through the present; that intervenor/plaintiffs' federal retirement benefits have been and continue to be exempt from state income taxation under the circumstances; that intervenor/plaintiffs are not required to pay state income taxes on their federal retirement benefits in the future; and that intervenor/plaintiffs are entitled to a refund of all discriminatory state income tax revenues paid and/or collected since 1984 in connection with their federal retirement benefits, together with appropriate interest at the rate of 12% per year until paid in full;

C. That the Court enter a permanent injunction prohibiting the State of Kansas, the Department of Revenue, and all officers, agents and employees thereof from levying, assessing and/or collecting state income taxes on intervenor/plaintiffs' federal armed forces retirement benefits;

D. That the Court order the Department of Revenue to account to intervenor/plaintiffs and the class they seek to represent for all state income tax revenues collected or received since 1984 because of the taxation of intervenor/plaintiffs' federal retirement benefits;

E. That the Court enter judgment for intervenor/plaintiffs and the class they seek to represent, and against defendants for state income tax refunds to which intervenor/plaintiffs and their class are entitled for each tax year from 1984 through the present, together with interest, in a total amount exceeding $10,000.00; and

F. That the Court award intervenor and his class their costs, including reasonable attorney fees under 42 U.S.C. §1988, and as permitted in common law, and such other and further relief as may be deemed just and equitable under the circumstances.

* * * * * * * *

IN THE DISTRICT COURT OF
SHAWNEE COUNTY, KANSAS
DIVISION 4

WILLIAM H.LOBER and MARJORIE E. LOBER, husband and wife, EDWARD F. KELLOGG and RENATE O. KELLOGG, husband and wife, ROGER J. OLSON and NANCY W. OLSON, husband and wife, ROGER W. CLAY and BETTY J. CLAY, husband and wife, and LELAND W. KEISTER and PATRICIA K. KEISTER, husband and wife, and others similarly situated
Plaintiffs,

vs.

STATE OF KANSAS, DEPARTMENT OF REVENUE
Defendants
[Case No. 89-CV-1100]

JOURNAL ENTRY

Filed August 29, 1989

NOW ON THIS 29th day of August, 1989, comes on for hearing the Motion by plaintiffs William J. Lober, Jr., et al, to consolidate case number 89 CV 1100 with case number 89 CV 666, *Barker, et al v. State of Kansas*. The plaintiffs appear by and through counsel Terence A. Lober, of counsel with DAVIS, BEALL, McGUIRE & THOMPSON, Chartered. Plaintiffs counsel in *Barker, et al v. State of Kansas*, 89 CV 666, appear by and through Kevin Fowler of FRIEDEN & FORBES, Chartered. The State of Kansas appears by and through James F. Bartle, Special Assistant Attorney General, Kansas Department of Revenue. There are no other appearances.

WHEREUPON after having heard the statements and arguments of counsel, having heard the arguments and objections of all parties, having reviewed the files in case number 89 CV 1100 and case number 89 CV 666, and being otherwise well and duly advised in the premises, the Court finds that the Motion to Consolidate should be, and hereby is granted.

IT IS THEREFORE BY THE COURT ORDERED, ADJUDGED AND DECREED that case number 89 CV 1100 and case number 89 CV 666 be, and they hereby are, consolidated for purposes of trial and pending further order of this Court.

IT IS SO ORDERED.

Thomas R. Conklin
District Court Judge

* * * * * * * *

IN THE DISTRICT COURT OF
SHAWNEE COUNTY, KANSAS
DIVISION 4

KEYTON BARKER and WILLIAM RICHARDS, SR.,
for themselves and all others similarly situated
Plaintiffs,

v.

STATE OF KANSAS and KANSAS
DEPARTMENT OF REVENUE
Defendants.
[Case No. 89-CV-666]

WILLIAM H. LOBER and MARJORIE E. LOBER, husband and wife, EDWARD F. KELLOGG and RENATE O. KELLOGG, husband and wife, ROGER J. OLSON and

NANCY W. OLSON, husband and wife, ROGER W. CLAY and BETTY J. CLAY, husband and wife, and LELAND W. KEISTER and PATRICIA K. KEISTER, husband and wife, and others similarly situated
Plaintiffs,

vs.

STATE OF KANSAS, DEPARTMENT OF REVENUE
Defendants
[Case No. 89-CV-1100]

JOURNAL ENTRY

Filed on September 21, 1989

NOW on this 20th day of September, 1989, Case No. 89-CV-666 is before the Court on Plaintiffs' Motion for Leave to File a Second Amended Petition (filed and served August 10, 1989). Pursuant to the provisions of K.S.A. 60-215, K.S.A. 60-220(a) and K.S.A. 60-221, Plaintiffs seek leave to file a second amended petition which, *inter alia*, joins three additional defendants in their respective official capacities. Defendants State of Kansas and Kansas Department of Revenue do not oppose said motion.

WHEREUPON, after reviewing the pleadings and being otherwise well and fully advised in the premises, for good cause shown, the Court finds and concludes that Plaintiffs' motion should be and is hereby granted, and that the Second Amended Petition annexed to said motion should be filed forthwith.

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that Plaintiffs in Case No. 89-CV-666 are granted leave to immediately file their Second Amended Petition; that the Second Amended Petition annexed to the motion referenced above shall be deemed filed as of the date of this Journal Entry; and that Mike Hayden, Governor of the State of Kansas; Ed Rolfs,

Secretary of Revenue of the State of Kansas; and John Luttjohann, Director of Taxation of the State of Kansas, are hereby joined in Case No. 89-CV-666 as additional parties defendant, each in his respective official capacity, and the names of such official capacity defendants shall be added to the caption of Case No. 89-CV-666 for all purposes from the date of this Journal Entry.

Adrian Allen
District Court Judge

* * * * * * * *

IN THE DISTRICT COURT OF
SHAWNEE COUNTY, KANSAS
DIVISION 4

INTERVENTION ORDER

Filed September 21, 1989
[Caption Omitted in Printing]

NOW on this 20th day of September, 1989, the above-styled consolidated action is before the Court on the Motion of Applicant Anthony E. Corcoran to Intervene in Case No. 89-CV-666. Plaintiffs in both actions have consented to the intervention of Anthony E. Corcoran as a putative member of the plaintiff class, and Defendants have not opposed such intervention. Accordingly, this intervention motion is ripe for decision.

WHEREUPON, after reviewing the pleadings, being well and duly advised in the premises, and for good cause shown, the Court finds and concludes that Anthony E. Corcoran should be and is hereby permitted to intervene in Case No. 89-CV-666 for all purposes and further proceedings herein.

IT IS THEREFORE BY THE COURT ORDERED, ADJUDGED AND DECREED that Anthony E. Corcoran shall be

henceforth considered as an intervenor/plaintiff; that the Petition of Intervenor Anthony E. Corcoran shall be joined with the issues raised in Case No. 89-CV-666; and that the name of Anthony E. Corcoran shall be added as an intervenor in Case No. 89-CV-666 for all purposes from this date forward.

Adrian J. Allen
District Court Judge

* * * * * * *

IN THE DISTRICT COURT OF
SHAWNEE COUNTY, KANSAS
DIVISION 4

SECOND AMENDED PETITION
[Case No. 89-CV-666]

Filed September 22, 1989
[Caption Omitted in Printing]

Plaintiffs, for themselves and all others similarly situated, hereby allege and state as follows:

PARTIES PLAINTIFF

1. Plaintiff Keyton Barker is a citizen and domiciliary of Shawnee County, Kansas. Mr. Barker is a retired Noncommissioned Officer (NCO) of the United States who served 22 creditable years in the United States Army and attained the rank/grade of Sergeant First Class (SFC)/E-7 before retiring from the active military service in February 1968. Pursuant to applicable provisions of Title 10 of the United States Code, Plaintiff Barker has been and will continue to be a recipient of federal armed forces retirement benefits based upon his rank and years of service.

2. Plaintiff Pauline Barker is a citizen and domiciliary of Shawnee County, Kansas. She is and has been the lawful wife of Plaintiff Keyton Barker from at least tax year 1984 through the present, and Ms. Barker resides with her husband in Shawnee County, Kansas.

3. Plaintiff William Richards, Sr. is a citizen and domiciliary of Shawnee County, Kansas. Mr. Richards is a retired Commissioned Officer of the United States who served more than 27 creditable years in the United States Army and attained the rank/grade of Lieutenant Colonel (LTC)/O-5 before retiring from the active military service on July 1, 1970. Pursuant to applicable provisions of Title 10 of the United States Code, Plaintiff Richards has been and will continue to be a recipient of federal armed forces retirement benefits based upon his rank and years of service.

4. Plaintiff Ollun E. Richards is a citizen and domiciliary of Shawnee County, Kansas. She is and has been the lawful wife of Plaintiff William Richards, Sr. from at least tax year 1984 through the present, and Ms. Richards resides with her husband in Shawnee County, Kansas.

5. Plaintiff Andrew J. Peele is a citizen and domiciliary of Saline County, Kansas, and has been a single man from at least tax year 1984 through the present. Mr. Peele is a retired Noncommissioned Officer (NCO) of the United States who served more than 20 creditable years in the United States Air Force and attained the rank/grade of Master Sergeant (MSG)/E-7 before retiring from the active military service in May 1973. Pursuant to applicable provisions of Title 10 of the United States Code, Mr. Peele has been and will continue to be a recipient of federal armed forces retirement benefits based upon his rank and years of service.

6. Plaintiff Clarence Wolf is a citizen and domiciliary of Osage County, Kansas. Mr. Wolf is a retired Noncommissioned Officer (NCO) of the United States who served more than 20

creditable years in the United States Air Force and attained the rank/grade of Technical Sergeant (TSG)/E-6 before retiring from the active military service in October 1973. Pursuant to applicable provisions of Title 10 of the United States Code, Mr. Wolf has been and will continue to be a recipient of federal armed forces retirement benefits based upon his rank and years of service.

7. Plaintiff Flora B. Wolf is a citizen and domiciliary of Osage County, Kansas. She is and has been the lawful wife of Plaintiff Clarence Wolf from at least tax year 1984 through the present, and Ms. Wolf resides with her husband in Osage County, Kansas.

8. Plaintiff John G. Fowler is a citizen and domiciliary of Shawnee County, Kansas. Mr. Fowler is a retired Commissioned Officer of the United States who served more than 30 creditable years in the United States Army and attained the rank/grade of Colonel (COL)/O-6 before retiring from the active miliary service in May 1983. Pursuant to applicable provisions of Title 10 of the United States Code, Mr. Fowler has been and will continue to be a recipient of federal armed forces retirement benefits based upon his rank and years of service.

9. Plaintiff Carol B. Fowler is a citizen and domiciliary of Shawnee County, Kansas. She is and has been the lawful wife of Plaintiff John G. Fowler from at least tax year 1984 through the present, and Ms. Fowler resides with her husband in Shawnee County, Kansas.

10. Plaintiff Leonard W. Williams is a citizen and domiciliary of Saline County, Kansas. Mr. Williams is a retired Noncommissioned Officer (NCO) of the United States who served more than 22 creditable years in the United States Navy and attained the rank/grade of Senior Chief Petty Officer (E-8) before retiring from the active military service in October 1983. Pursuant to applicable provisions of Title 10 of the United States Code, Mr. Williams has been and will continue to be a recipient of federal armed forces retirement benefits based upon his rank and years of

service.

11. Plaintiff Loneta S. Williams is a citizen and domiciliary of Saline County, Kansas. She is and has been the lawful wife of Plaintiff Leonard W. Williams from at least tax year 1984 through the present, and Ms. Williams resides with her husband in Saline County, Kansas.

12. Plaintiff class sought to be certified herein consists of all retired members of the federal armed forces who are past, present and/or future recipients of federal retirement benefits (under applicable provisions of Title 10 of the United States Code) which have been and remain subject to state income taxation pursuant to the Kansas Income Tax Act and, where applicable, their spouses who have filed and/or will file joint state income tax returns in the State of Kansas. Upon information and belief, Plaintiffs allege that there are more than 10,000 members of this class.

PARTIES DEFENDANT

13. Defendant State of Kansas ("State") is a duly recognized and admitted state of the Union of the United States of America and may be served with process by serving its counsel of record herein, Mark Burghart and James Bartle, Docking State Office Building, Legal Services, 915 S.W. Harrison Street, Topeka, Kansas 66612-1588.

14. Defendant Kansas Department of Revenue ("Department of Revenue" or "Department") is an agency and instrumentality of the State of Kansas created and existing under the authority of K.S.A. 75-5101 *et seq.* and any amendments thereto, and may be served with process by serving its counsel of record herein, Mark Burghart and James Bartle, Docking State Office Building, 915 S.W. Harrison Street, Topeka, Kansas 66612-1588.

15. Defendant Mike Hayden is the duly elected and

acting Governor of the State of Kansas, who is responsible for the enforcement of the laws of the State under the provisions of Article 1, Section 3 of the Constitution of the State of Kansas, and may be served with process at the Office of the Governor, State Capitol Building, Topeka, Kansas 66612.

16. Defendant Ed Rolfs is the duly appointed and acting Secretary of Revenue of the State of Kansas, who is the head of and responsible for directing and supervising the administration of the Kansas Department of Revenue pursuant to K.S.A. 75-5101, and may be served with process at the Office of the Secretary of Revenue, Kansas Department of Revenue, Docking State Office Building, 915 S.W. Harrison, Topeka, Kansas 66612.

17. Defendant John Luttjohann is the duly appointed and acting Director of Taxation of the State of Kansas and may be served with process at the office of the Director of Taxation, Kansas Department of Revenue, Docking State Office Building, 915 S.W. Harrison, Topeka, Kansas 66612. The Director of Taxation, as the head of the Department's Division of Taxation pursuant to K.S.A. 75-5102, is responsible for administration of the Kansas Income Tax Act under K.S.A. 79-3233.

FACTUAL BACKGROUND

18. Pursuant to pertinent provisions of the Kansas Income Tax Act (K.S.A. 79-3201 *et seq.* and amendments thereto), Plaintiffs Keyton Barker, William Richards, Sr., Andrew J. Peele, Clarence Wolf, John G. Fowler and Leonard Williams have been required to pay and have paid Kansas state income taxes on their federal retirement benefits during each year from 1984 through the present. During this same period, Plaintiffs Pauline Barker, Ollun E. Richards, Flora B. Wolf, Carol B. Fowler and Loneta S. Williams, having an undivided interest in the federal retirement benefits received by and as joint taxpayers with their respective spouses, have likewise paid Kansas state income taxes

on said federal retirement benefits.

19. At all times relevant since 1984, acting under the supervision of the Governor and the Secretary of Revenue, the Director of Taxation has collected, received and disposed of such income tax payments under the color of state law for and on behalf of the State of Kansas and the Kansas Department of Revenue.

20. Pursuant to the provisions of K.S.A. 79-32,117(c)(11) and K.S.A. 74-4923(b), together with amendments thereto, all retirement benefits paid by the State under the Kansas public employees retirement system (K.S.A. 74-4901 *et seq.* and amendments thereto) and the Kansas Police and Firemen's Retirement System (K.S.A. 74-4951 *et seq.* and amendments thereto) have been specifically exempt from state income taxation during each year from at least 1984 through the present. In addition, amounts received as annuities under the federal civil service retirement system; amounts received by retired railroad employees as supplemental annuity benefits; and amounts received by retired employees of a city and by retired employees of any board of such city in accordance with K.S.A. 13-14,106 or exemptions therefrom, have been likewise exempt from state income taxation, under the provisions of K.S.A. 79-32,117(c) and amendments thereto, during each year from at least 1984 through the present.

21. The retirement, pension and/or annuity benefits referenced in Paragraph 20 above will remain exempt from Kansas state income taxation for the indefinite future absent a change in state law. Likewise, the federal retirement benefits received by Plaintiffs will remain subject to such state income taxation for the indefinite future absent an authoritative judicial decree or other change in state law.

22. Such inconsistent treatment of retirement benefits for state income tax purposes constitutes discriminatory taxation which is neither directly related to nor justified by significant differences between the classes of retirees. Consequently, state

income taxation of Plaintiffs' federal retirement benefits violates 4 U.S.C. § 111 and constitutional principles of intergovernmental tax immunity as discussed and applied in *Davis v. Michigan Department of Treasury*, No. 87-1020, 57 U.S.L.W. 4389 (U.S. Sup.Ct., Mar. 28, 1989).

23. Pursuant to K.S.A. 60-223, Plaintiffs seek to represent the class of all persons similarly situated which is identified and defined in Paragraph 12 above. Plaintiffs are all members of the proposed class; their claims are typical of the claims of all class members; and they will fairly and adequately represent and protect the interests of all class members.

24. Since the proposed class identified in Paragraph 12 above consists of more than 10,000 retired members of the federal armed forces and, where applicable, their respective spouses, joinder of all such class members is impracticable. Moreover, questions of law and fact common to members of the class predominate over any questions affecting individual members, and a class action is superior to all other available methods for securing a fair and efficient adjudication of this controversy.

COUNT I - DEPRIVATION OF FEDERAL CIVIL RIGHTS

25. The allegations articulated in Paragraphs 1 through 24 above are hereby incorporated by reference as though fully set forth herein.

26. Defendants State of Kansas and Department of Revenue; and Defendants Governor Hayden, Secretary Rolfs, and Direct Luttjohann, in their official capacities and through various officers, agents and employees of the state; all acting pursuant to and otherwise under the color of state law, have subjected Plaintiffs or caused Plaintiffs to be subjected to the deprivation of rights, privileges or immunities secured by the Constitution and laws of the United States in violation of the Fourteenth Amendment and 42 U.S.C. § 1983.

27. As a result of such deprivation of federally-protected civil rights, privileges or immunities, Plaintiffs and the class they seek to represent have suffered substantial and irreparable damages, for which there is no adequate remedy at law, and will continue to suffer such damages absent permanent injunctive relief which prohibits the State of Kansas, Department of Revenue, the Governor, the Secretary of Revenue and/or the Director of Taxation from taking any direct or indirect action to subject Plaintiffs' federal retirement benefits to Kansas state income taxation.

COUNT II - DEPRIVATION OF STATE CONSTITUTIONAL RIGHTS

28. The allegations articulated in Paragraphs 1 through 24 above are hereby incorporated by reference as though fully set forth herein.

29. The Constitution of the State of Kansas, Article 11, Section 2 implicitly prohibits Defendants from levying and collecting taxes on income based upon arbitrary, capricious and discriminatory classifications.

30. Under the circumstances described herein, Plaintiffs allege that state income taxation of their federal retirement benefits, including the levying and collection of such taxes, subjects them to unequal treatment and is impermissibly based upon arbitrary, capricious and discriminatory classifications in violation of KAN. CONST., art. 11 § 2.

31. As a result of such deprivation of state civil rights, privileges or immunities, Plaintiffs and the class they seek to represent have suffered substantial and irreparable damages, for which there is no adequate remedy at law, and will continue to suffer such damages absent permanent injunctive relief which prohibits the State of Kansas, Department of Revenue, the Governor, the Secretary of Revenue and/or the Director of Taxation from taking any direct or indirect action to subject

Plaintiffs' federal retirement benefits to Kansas state income taxation. Moreover, Plaintiffs and the class they seek to represent are entitled to a refund, together with appropriate interest at the rate of 12% per year from the date(s) of overpayment, of all discriminatory state income taxes collected from 1984 through the present.

COUNT III - DECLARATORY JUDGMENT

32. The allegations articulated in Paragraphs 1 through 31 above are hereby incorporated by reference as though fully set forth herein.

33. An actual case and controversy exists between the parties under the provisions of K.S.A. 60-1701 *et seq.* regarding the arbitrary and discriminatory taxation of Plaintiffs' federal retirement benefits under the Kansas Income Tax Act. Absent judicial declaration that the state income tax act is unconstitutional as applied and that federal armed forces retirees are exempt from paying state income tax on their federal retirement benefits, Plaintiffs and the class they seek to represent will continue to suffer substantial and irreparable injuries and damages, now and in the future.

COUNT IV - ACCOUNTING AND REFUND OF STATE INCOME TAXES ON FEDERAL RETIREMENT BENEFITS

34. The allegations articulated in Paragraphs 1 through 24, Paragraphs 28 through 31 and Paragraph 33 above are hereby incorporated by reference as though fully set forth herein.

35. Defendants State of Kansas, Kansas Department of Revenue, the Governor of the State of Kansas, the Secretary of Revenue and/or the Director of Taxation have subjected Plaintiffs and the class they seek to represent to arbitrary and discriminatory income taxation of federal retirement benefits since at least 1984. At all times pertinent hereto, acting under the supervision of the

Governor and the Secretary of Revenue, the Director of Taxation has collected, received and disposed of income tax revenues from said federal retirement benefits for and on behalf of the State; and Plaintiffs, including the class they seek to represent, have paid such arbitrary and discriminatory state income taxes on such federal retirement benefits.

36. Under the circumstances presented, Plaintiffs and the class they seek to represent are entitled to an accounting of all such discriminatory income taxes collected from 1984 through the present and to a refund, together with appropriate interest at the rate of 12% per year from the date(s) of overpayment, of all such monies.

37. While Plaintiffs acknowledge the existence of certain administrative remedies to obtain state income tax refunds, such administrative mechanisms are plainly incapable of affording Plaintiffs any relief from legislatively-imposed, albeit discriminatory, state income taxation and recourse to such procedures would be futile under the circumstances. The absence of any full and effective administrative remedy therefore excuses Plaintiffs and the class they seek to represent from any requirement which might otherwise exist to pursue and/or exhaust any such administrative mechanisms.

38. Plaintiffs and the class they seek to represent are entitled to state income tax refunds, together with interest, in a substantial amount which probably exceeds $1,000,000.00 per year for each tax year from 1984 through the present.

PRAYER FOR RELIEF

WHEREFORE, premises considered, Plaintiffs pray for the following relief:

A. That the Court determine, as soon as practicable, that this case is a proper class action; that Plaintiffs are proper class representatives; and that no notice of this action need be

given to members of the class represented by these named plaintiffs, all in accordance with K.S.A. 60-223;

B. That the Court issue its judicial declaration that the Kansas Income Tax Act is unconstitutional as applied to Plaintiffs' federal retirement benefits; that Defendants, under the color of state law, have wrongfully subjected Plaintiffs or caused Plaintiffs to be subjected to arbitrary and discriminatory income taxation in violation of the Constitution and laws of the United States from at least 1984 through the present; that Plaintiffs' federal retirement benefits have been and continue to be exempt from state income taxation under the circumstances; that Plaintiffs are not required to pay state income taxes on their federal retirement benefits in the future; and that Plaintiffs are entitled to a refund of all discriminatory state income tax revenues paid and/or collected since 1984 in connection with their federal retirement benefits, together with appropriate interest at the rate of 12% per year until paid in full;

C. That the Court enter a permanent injunction prohibiting the State of Kansas, the Kansas Department of Revenue, the Governor of the State of Kansas, the Secretary of Revenue of the State of Kansas, the Director of Taxation of the State of Kansas and all other officers, agents and employees of the State from levying, assessing and/or collecting state income taxes on Plaintiffs' federal armed forces retirement benefits;

D. That the Court order the Kansas Department of Revenue, the Secretary of Revenue of the State of Kansas and/or the Director of Taxation of the State of Kansas to account to Plaintiffs and the class they seek to represent for all state income tax revenues collected or received since 1984 because of such taxation of Plaintiffs' federal retirement benefits;

E. That the Court enter judgment for Plaintiffs and the class they seek to represent, and against Defendants State of Kansas, Kansas Department of Revenue, the Secretary of Revenue of the State of Kansas and/or the Director of Taxation of the State

of Kansas for state income tax refunds to which Plaintiffs and Plaintiff class are entitled for each tax year from 1984 through the present, together with interest, in a total amount exceeding $10,000.00; and

F. That the Court award Plaintiffs their costs, including reasonable attorney fees under 42 U.S.C. § 1988, and such other and further relief as may be deemed just and equitable under the circumstances.

* * * * * * * *

IN THE DISTRICT COURT OF
SHAWNEE COUNTY, KANSAS
DIVISION 4

AMENDED JOINT MOTION FOR CLASS CERTIFICATION

Filed October 24, 1989
[Caption Omitted in Printing]

Pursuant to the provisions of K.S.A. 60-223, all Plaintiffs in this consolidated action [Case No. 89-CV-666 and Case No. 89-CV-1100] respectfully move this Honorable Court for an order: (1) certifying this consolidated litigation as a class action; (2) naming all Plaintiffs as class representatives; (3) defining the Plaintiff Class as:

> All retired members of the federal or United States armed forces who are recipients of federal armed forces retirement benefits (under applicable provisions of Title 10 or Title 14 of the United States Code) subject to Kansas state income taxation during one or more of the tax years from 1984 through 1989 and, where applicable, their respective spouses who have filed or will file joint

> Kansas state income tax returns during one or more of the tax years from 1984 through 1989;

and (4) designating class counsel as the law firms of FRIEDEN, HAYNES & FORBES of Topeka, NIEWALD, WALDECK, NORRIS & BROWN of Overland Park, and DAVIS, BEALL, MCGUIRE & THOMPSON of Leavenworth.

This amended motion is identical to Plaintiffs' original Joint Motion for Class Certification except for the addition of the phrase "or Title 14" to the definition of our proposed Plaintiff Class. While Coast Guard personnel are members of the federal armed forces under Title 10 of the United States Code [*see* 10 U.S.C. § 101(4)] whose retirement pay is determined, in whole or in part, under 10 U.S.C. §§ 1405, 1407 and/or 1409, Plaintiffs' counsel recently learned that Coast Guard retirement benefits are actually payable under Title 14 of the United States Code. *See, e.g.*, 14 U.S.C.A. §§ 421 and 423 (1989 Cum. Ann. Pocket Pt.). This purely technical amendment to our class definition is necessary to clarify and ensure that retired members of the Coast Guard who received federal armed forces retirement benefits are included within the Plaintiff Class proposed herein.

For the reasons articulated in our Memorandum in Support of Plaintiffs' Joint Motion for Class Certification (filed September 28, 1989), Plaintiffs respectfully submit that the requirements of K.S.A. 60-223 are satisfied and that this consolidated litigation should be certified and maintained as a class action.

WHEREFORE, premises considered, Plaintiffs jointly pray that this motion be granted.

* * * * * * * *

IN THE DISTRICT COURT OF
SHAWNEE COUNTY, KANSAS
DIVISION 4

JOURNAL ENTRY DISMISSING GOVERNOR MIKE HAYDEN AS A PARTY DEFENDANT IN CASE NO. 89-CV-666

Filed November 1, 1989
[Caption Omitted in Printing]

NOW on this 1st day of November, 1989, Case No. 89-CV-666 is before the Court on a joint motion to dismiss Governor Mike Hayden as a party defendant herein. Plaintiffs in Case No. 89-CV-666 appear by and through their attorney, John C. Frieden of FRIEDEN, HAYNES & FORBES; Intervenor/Plaintiff Anthony E. Corcoran appears by and through his attorney, Kenton C. Granger of NIEWALD, WALDECK, NORRIS & BROWN; and Defendant Governor Mike Hayden appears by and through his attorney, Assistant Attorney General Mary K. Wettig. There are no other appearances.

WHEREUPON, after reviewing the pleadings and being otherwise well and fully advised in the premises, for good cause shown, the Court finds and concludes, pursuant to the provisions of K.S.A. 60-223(e) and K.S.A. 60-241(a)(2), that Defendant Governor Hayden should be and is hereby dismissed from Case No. 89-CV-666 upon the following terms and conditions:

1. Governor Hayden agrees to be bound by any injunctive relief which may be issued by the Court herein;

2. Dismissal of Governor Hayden will not prejudice the rights of appeal of any party in Case No. 89-CV-666 nor will it affect or prejudice Plaintiffs' rights to seek an award of attorney's fees under 42 U.S.C. § 1988 against any remaining parties defendant; and

3. Each and every named Plaintiff in Case No. 89-CV-666 and Governor Hayden mutually covenant not to sue each other or otherwise pursue any claim for attorney's fees under 42 U.S.C. § 1988 which might exist in connection with the subject-

matter of this action; and that said covenant shall not affect or prejudice Plaintiffs' rights to seek an award of attorney's fees under 42 U.S.C. § 1988 against Defendants State of Kansas, Kansas Department of Revenue, Secretary of Revenue Ed Rolfs and/or Director of Taxation John Luttjohann.

The Court further finds and concludes that dismissal of Defendant Governor Hayden will not interfere with the orderly progress of this action nor will it prejudice the interests of Plaintiffs and the class they seek to represent.

IT IS SO ORDERED.

Entered this 1st day of November, 1989, at Topeka, Kansas.

Adrian J. Allen
District Court Judge

* * * * * * * *

IN THE DISTRICT COURT OF
SHAWNEE COUNTY, KANSAS
DIVISION 4

JOURNAL ENTRY

Filed December 19, 1989
[Caption Omitted in Printing]

NOW on this 13th day of November, 1989, the above-captioned consolidated action is before the Court, pursuant to notice, for hearing and disposition of Defendants' motions to dismiss and Plaintiffs' amended joint motion for class certification. Plaintiffs in Case No. 89-CV-666 appear by their attorneys, John C. Frieden and Kevin M. Fowler; Plaintiff/Intervenor Corcoran appears by his attorneys, Kenton C. Granger and Angela K.

Green; Plaintiffs in Case No. 89-CV-1100 appear by their attorney, Terence A. Lober; and Defendants appear by their attorneys, James Bartle and Mark Burghart. There are no other appearances.

WHEREUPON, after reviewing the pleadings, memoranda, affidavits, documents of record, hearing the arguments of counsel, and being otherwise well and fully advised in the premises, the Court issues the following Findings of Fact and Conclusions of Law:

I

FINDINGS OF FACT

1. The statements of fact set forth in the Affidavit of Keyton E. Barker, Jr., Affidavit of Pauline Barker, Affidavit of William E. Richards, Affidavit of Ollun E. Richards, Affidavit of John G. Fowler, Affidavit of Carol B. Fowler, Affidavit of Leonard W. Williams, Affidavit of Loneta S. Williams, Affidavit of Clarence Wolf, Affidavit of Flora B. Wolf, Affidavit of Anthony E. Corcoran, Affidavit of Leland W. Keister, Jr., Affidavit of Roger J. Olson, Affidavit of Edward F. Kellogg, Affidavit of Joseph Marshall, Affidavit of John Luttjohann, Affidavit of Kevin M. Fowler and Affidavit of John C. Frieden, each of which is duly filed with the Court without objection by the parties, are accepted as true for purposes of Defendants' motions to dismiss and Plaintiffs' joint motion for class certification, and are hereby incorporated by reference as though fully articulated herein.

2. The parties have also executed a Stipulation of Authenticity of Specific Documents which was filed with the Court on November 9, 1989. The Court does hereby accept this stipulation and finds that the documents attached thereto are authentic.

3. Based upon *Davis v. Michigan Department of Treasury*, 109 S.Ct. 1500, 103 L.Ed.2d 891 (1989), 4 U.S.C. §

111 and the Supremacy Clause of the United States Constitution, the Privileges and Immunities Clause of the Fourteenth Amendment, and Article 11, § 2 of the Kansas Constitution, all named Plaintiffs and the class they seek to represent allege that Kansas state income taxation of military retired pay, as legislatively imposed under the Kansas Income Tax Act [K.S.A. 79-3201 *et seq.* as amended], is unconstitutional. None of the parties have offered or identified any non-constitutional basis for decision.

4. The proposed class involved in these consolidated proceedings consists of all retired members of the federal or United States armed forces who are recipients of federal armed forces retirement benefits [under applicable provisions of Title 10 or Title 14 of the United States Code] subject to Kansas state income taxation during one or more of the tax years from 1984 through 1989 and, where applicable, their respective spouses who have filed or will file joint Kansas state income tax returns during one or more of the tax years from 1984 through 1989. There are approximately 14,100 members of this class and joinder of all members is impracticable.

5. There are questions of law and fact common to each member of the class. Moreover, the claims of all named Plaintiffs are typical of the claims of the class, to wit: Whether Kansas state income taxation of military retired pay violates our federal and/or state constitutions.

6. Plaintiffs' counsel [FRIEDEN, HAYNES & FORBES; NIEWALD, WALDECK, NORRIS & BROWN, P.C.; and DAVIS, BEALL, MCGUIRE & THOMPSON, Chartered] are qualified, experienced and capable of conducting the proposed class action litigation. In addition, the conduct of these proceedings demonstrates that the current parties are not involved in a collusive suit and there is no evidence of record which suggests otherwise.

7. The interests of the named Plaintiffs do not conflict

with nor do they appear to be antagonistic in any way with the interests of other members of the class. Likewise, Plaintiffs' interests in the subject-matter are at least co-extensive with the interests of other members of the class.

8. The named parties Plaintiff in these consolidated proceedings, with the assistance of their attorneys, will adequately represent and protect the interests of the class involved herein; and all such named Plaintiffs should be designated as class representatives. Furthermore, the law firms of FRIEDEN, HAYNES & FORBES; NIEWALD, WALDECK, NORRIS & BROWN; and DAVIS, BEALL, MCGUIRE & THOMPSON, should be designated as class counsel.

9. Defendants have conceded that neither the Director of Taxation of the State of Kansas nor the Board of Tax Appeals ["BOTA"] is authorized or empowered to grant any Plaintiff or class member any relief from Kansas income taxation at issue in these proceedings. Defendants therefore have acted and refused to act on grounds generally applicable to the class.

10. Separate actions by individual class members would create a risk of individual adjudications which would, as a practical matter, dispose of the interests of non-parties similarly situated or substantially impede or impair the ability of such non-parties to protect their interests.

11. Under the circumstances presented, pursuit and exhaustion of existing administrative remedies by any Plaintiffs and members of the class involved herein would be futile. Moreover, the limited state income tax refund remedy is inadequate and the administrative process is fraught with lengthy delays that will serve no useful purpose.

II
CONCLUSIONS OF LAW

1. This Court has judicial power and such jurisdiction

in its respective district as may be provided by law. KAN. CONST., art. 3 at §§ 1 and 6(b). The broad scope of such authority has been specified by the Kansas Legislature in K.S.A. 20-301, which grants this Court "general original jurisdiction of all matters, both civil and criminal, unless otherwise provided by law, and also . . . such appellate jurisdiction as prescribed by law." Since the power to decide the subject-matter of this civil action has not been expressly withheld nor ceded exclusively to another tribunal, this Court has original jurisdiction.

2. Exhaustion of administrative remedies may be required in tax matters where there exists a full and adequate administrative remedy provided by statute. However, exhaustion is not required where the remedy is inadequate or recourse to the administrative process would be futile. In this case, application of the exhaustion doctrine is not appropriate because the administrative process is incapable of providing any Plaintiff and member of the class with any form of relief. The only available administrative remedy [e.g., the income tax refund mechanism] is therefore inadequate and pursuit of this remedy would be futile.

3. Application of the exhaustion doctrine is also not appropriate in this case because the questions presented are inherently judicial, they do not involve administrative discretion and they do not require administrative expertise. Consequently, administrative fact finding and proceedings will not assist the Court in resolution of the issues presented for decision.

4. Plaintiffs have filed proper petitions, affidavits and documents sufficient to establish a prima facie set of facts sufficient to warrant certification of these proceedings as a class action under the provisions of K.S.A. 60-223(a), (b)(1), and (b)(2). The Court therefore certifies these consolidated proceedings as a class action under K.S.A. 60-223(b)(1) and (b)(2); designates all named Plaintiffs as class representatives; defines the Plaintiff class as:

All retired members of the federal or United

> States armed forces who are recipients of federal armed forces retirement benefits [under applicable provisions of Title 10 or Title 14 or the United States Code] subject to Kansas state income taxation during one or more of the tax years from 1984 through 1989 and, where applicable, their respective spouses who have filed or will file joint Kansas state income tax returns during one or more of the tax years from 1984 through 1989;

and designates class counsel as the law firms of FRIEDEN, HAYNES & FORBES; NIEWALD, WALDECK, NORRIS & BROWN, P.C.; and DAVIS, BEALL, MCGUIRE & THOMPSON, Chartered.

5. No notice of this Order shall be required, but a copy hereof shall be attached to any class notices which may be hereafter required by the Court.

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that Defendants' motions to dismiss should be and are hereby denied.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that Plaintiffs' amended joint motion for class certification should be and is hereby granted.

DATED this 19th day of December, 1989.

Adrian Allen
District Court Judge

* * * * * * *

IN THE DISTRICT COURT OF
SHAWNEE COUNTY, KANSAS
DIVISION 4

PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT ON THE QUESTION OF LIABILITY

Filed February 23, 1990
[Caption Omitted in Printing]

Pursuant to the provisions of K.S.A. 1989 Supp. 60-256(c), the designated Plaintiff Class as a whole and all named Plaintiffs, individually and as designated class representatives in these consolidated class action proceedings, hereby move the Court for summary judgment on the legal question of whether Kansas state income taxation of federal military retired pay, as legislatively imposed under the Kansas Income Tax Act [K.S.A. 79-3201 *et seq.* and amendments thereto] is unconstitutional because it violates 4 U.S.C. § 111 and the Supremacy Clause of the Constitution of the United States, the constitutional doctrine of intergovernmental tax immunity, the Privileges and Immunities Clause of the Fourteenth Amendment, and Article 11, § 2 of the Constitution of the State of Kansas. Plaintiffs also request entry of a permanent injunction prohibiting any and all Defendants [including their agents and employees] from enforcing any state income tax levy or assessment against federal military retired pay until and unless such federal retirement benefits are treated in the same manner as state and local retirement benefits under the Kansas Income Tax Act. Finally, Plaintiffs seek a summary determination of their entitlement to a refund, plus statutory interest, of income taxes paid under the State's unconstitutional tax scheme for all tax years from 1984 through the present.

For the reasons articulated in the Memorandum in Support of Plaintiffs' Motion for Summary Judgment on the Question of Liability filed contemporaneously herewith, Plaintiffs respectfully submit that the judgment sought should be rendered forthwith since there are no genuine issues as to any material fact and we are entitled to such judgment as a matter of law.

Plaintiffs request oral argument on this motion at the earliest possible opportunity.

* * * * * * * *

IN THE DISTRICT COURT OF
SHAWNEE COUNTY, KANSAS
DIVISION 4

AFFIDAVIT OF SUSAN IRZA

Filed April 16, 1990
[Caption Omitted in Printing]

STATE OF KANSAS, COUNTY OF SHAWNEE, SS:

SUSAN IRZA, of lawful age, being first duly sworn on her oath, alleges and states as follows:

1. I am employed by the Kansas Department of Administration as the Director of the Division of Personnel Services.

2. My responsibilities and duties as Director include developing effective personnel administration within all agencies in the state.

3. The Department of Administration is statutorily charged with the administration of all personnel matters regarding persons employed by the state of Kansas in the state civil service system.

4. My official duties and responsibilities require me to be knowledgeable of the personnel requirements of the state civil service system.

5. Upon their retirement, retired state employees are completely severed from employment obligations with the state of Kansas.

6. The state of Kansas has no authority, policy, or procedure to recall retired state employees to employment with the state under any circumstances.

7. The state of Kansas has personnel procedures and disciplinary rules and regulations for its employees. However, retired state employees are not subject to such procedures, rules and regulations.

8. Retired state employees are not subject to restrictions on post-retirement activities, except as to a limited exception regarding re-employment with the state and reduction of KPERS retirement benefits if the current earned compensation exceeds $6,000.00 in a calendar year.

9. Retired state employees are not provided with free hospitalization, health, or dental care by the state of Kansas. State retirees may continue to purchase group health insurance through the state and are responsible for the full cost of such health insurance.

10. The state of Kansas does not operate special stores where current or retired state employees can purchase items at reduced prices or without paying sales tax on their purchases.

11. The state of Kansas does not provide free or reduced fare transportation on aircraft for retired state employees as part of its retirement system.

FURTHER AFFIANT SAITH NOT.

* * * * * * *

IN THE DISTRICT COURT OF
SHAWNEE COUNTY, KANSAS
DIVISION 4

AFFIDAVIT

Filed April 16, 1990
[Caption Omitted in Printing]

I, Judy A. Lambert, of lawful age, being first duly sworn, hereby state as follows:

1. I am employed by the Kansas Public Employees Retirement System (KPERS) as Chief of Member Services.

2. My duties and responsibilities as Chief of Member Services include managing and directing the operations of the division pertaining to member services. These operations include, but are not limited to, calculation of members' benefits (including retirement benefit payments), maintenance of members' records, preparation of annual statements of members' accounts, and preparation of necessary tax forms.

3. KPERS is an organization created by law to administer the retirement systems of all participating employers, including the retirement system for employees of the state of Kansas and its political subdivisions, teachers and school employees, and the Kansas Police and Firemen's Retirement System.

4. My official duties and responsibilities require me to be familiar with and knowledgeable of the administration of KPERS and the rules, regulations, and laws pertaining to the organization.

5. KPERS retirement benefits are funded by regular employee contributions, employer contributions, and interest and earnings on the invested contributions. Employee contributions are deducted from gross pay each payroll period at the prescribed statutory rate. Employer contributions are funded annually.

6. State employees are required by law to participate

in and make contributions to KPERS after working for the state for one year.

7. Regular contributions to KPERS made by state employees are subject to Kansas income tax in the year in which they are made.

8. A state employee may withdraw his KPERS contributions together with interest accrued thereon, after terminating employment with the state. Employer contributions remain with the fund.

9. Retired state employees cannot receive the full amount of their KPERS benefits until they are 65 years of age, unless they are 60 and have 35 years of service, or at any age if they have 40 years of service.

10. State employees with 10 years of service can retire as early as age 55, but their monthly benefit payments will be substantially reduced. Such employees do not receive an increase in benefits when they reach age 65.

11. Retired state employees are not subject to restrictions on their post-retirement activities as a condition to receiving KPERS benefits. However, if a retirant who retired on or after July 1, 1988, is reemployed by the state and earns more than $6,000 in a calendar year, KPERS benefits will be suspended if he or she continues to work for the state. This provision does not apply to retirants retiring before July 1, 1988.

12. KPERS retirement benefits are deferred compensation for the past services rendered. Retirants are not required to perform additional services or duties to receive KPERS retirement benefits.

13. There is no automatic cost of living increase in KPERS retirement benefit payments based on the consumer price index or any other formula.

14. KPERS nonschool average annual retirement benefit payment in 1986 was $4,008.

15. Generally, it takes 2 to 3 years for a retirant to receive an amount equal to his contributions through retirement benefit payments.

FURTHER AFFIANT SAITH NOT.

* * * * * * * *

IN THE DISTRICT COURT OF
SHAWNEE COUNTY, KANSAS
DIVISION 4

MEMORANDUM DECISION AND ORDER

Filed October 31, 1990

This matter comes before the Court on plaintiffs' motion for summary judgment on the issue of liability. The defendants have responded to plaintiffs' motion and have also moved for summary judgment on the issue of whether the defendants can be held liable under 42 U.S.C. § 1983.

All named plaintiffs served at least twenty (20) years in the United States Armed Forces which include the Army, Navy and Air Force. They have been noncommissioned and commissioned officers. All named plaintiffs are Kansas residents who have paid and continue to pay Kansas income taxes. Named plaintiffs represent a certified class of approximately 14,000 federal military retirees in the State of Kansas. *Journal Entry* at 3, para. 4 (Dec. 19, 1989).

Plaintiffs brought this action challenging the Kansas Income Tax Act (KITA) (K.S.A. § 79-3201 *et seq.*) claiming it discriminates against federal military retirees and therefore, is

unconstitutional because it violates 4 U.S.C. § 111 and the Supremacy Clause of the United States Constitution, the constitutional doctrine of intergovernmental tax immunity, the Privileges and Immunities Clause of the Fourteenth Amendment, and article XI, § 2 of the Kansas Constitution. *Second Amended Petition* at 9 & 11 (Sept. 22, 1989). Plaintiffs allege defendants deprived plaintiffs of their civil rights in violation of the United States Constitution, the Fourteenth Amendment and 42 U.S.C. § 1983. *Id.* at 10.

Plaintiffs also request a refund of Kansas income taxes since 1984, with interest, which are allegedly overpayments. *Id.* at 13. Plaintiffs have preserved their right to a refund by the order of this Court which recognized that plaintiffs could not receive the relief sought from the administrative process due to the Kansas Department of Revenue's inability to declare a state statute unconstitutional. *Journal Entry* at 5-6, para. 2 & 3 (Dec. 19, 1989).

CONCLUSIONS OF LAW

Federal income tax is based upon the taxpayer's federal adjusted gross income pursuant to provisions of the Internal Revenue Code. *See* 26 U.S.C. §§ 61 to 134. Federal adjusted gross income includes federal military retired pay, federal civil service retirement pay and retirement benefits paid to the States' civil service retirees, such as retired members of the Kansas Public Employees Retirement Systems.

Kansas income tax is based upon the taxpayer's Kansas adjusted gross income. An individual's federal adjusted gross is modified pursuant to K.S.A. § 79-32,117 to calculate his Kansas adjusted gross income. To arrive at an individual's Kansas adjusted gross income, his federal adjusted gross income is reduced by the amount received from the federal civil service retirement and disability fund, amounts received by retired railroad employees as a supplemental annuity, and amounts received from the Kansas Employee Retirement Systems by retired members.

K.S.A. §§ 79-32,117(c) (1989) and 74-4924 (1985). The Kansas adjusted gross income includes the amount received from military retired pay and therefore, military retirees pay taxes on military retired pay. *See* K.S.A. § 79-32,117 (1989).

Plaintiffs brought this action challenging the Kansas Income Tax Act and request tax refunds as a response to the United States Supreme Court decision in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 109 S.Ct. 1500, 103 L.Ed.2d 891 (1989). In *Davis*, the plaintiff, a retired Federal Government employee receiving federal civil service retirement benefits, challenged the Michigan state income tax. The Michigan state income tax act taxed federal civil service retirement benefits while exempting state civil service retirement benefits. Therefore, the plaintiff claimed the Michigan income tax scheme was unconstitutional under the doctrine of intergovernmental tax immunity and 4 U.S.C. § 111.

The doctrine of intergovernmental tax immunity has its roots in *McCulloch v. Maryland*, 4 Wheat 316, 4 L.Ed. 579 (1819), which held a state could not impose a discriminatory tax on an agent of the United States and thereby, indirectly tax the Federal Government. This doctrine was more fully developed in *Helvering v. Gerhart*, 304 U.S. 405, 58 S.Ct. 969, 82 L.Ed. 1427 (1938), and in *Graves v. New York ex rel. O'Keefe*, 306 U.S. 466, 59 S.Ct. 595, 83 L.Ed. 927 (1939). In *Helvering* the Supreme Court held that the Federal Government could levy nondiscriminatory taxes on the incomes of most state employees. The Supreme Court in *Graves* held federal employees were subject to nondiscriminatory taxes levied by the States. "After *Graves*, therefore, intergovernmental tax immunity barred only those taxes that were imposed directly on one sovereign by the other or that discriminated against a sovereign or those with whom it dealt." *Davis*, 103 L.Ed.2d at 902.

The principle of allowing States to tax the Federal Government "or those with whom it dealt" as long as the tax did not discriminate against the Federal Government was codified in

part by 4 U.S.C. § 111. This statute was passed between the announcements of *Helvering* and *Graves* and states in pertinent part "[t]he United States consents to the taxation of pay or compensation for personal services as [a federal employee], . . ., by a duly constituted taxing authority having jurisdiction, *if the taxation does not discriminate* against the officer or employee *because of the source* of the pay or compensation." (Emphasis added). After determining that 4 U.S.C. § 111 applies to retired as well as current federal employees, the Supreme Court in *Davis* states "the relevant injury is whether the inconsistent tax treatment is directly related to and justified by 'significant differences between the two classes.'" *Davis*, 103 L.Ed.2d at 905 [citing *Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U.S. 376, 383, 80 S.Ct. 474, 4 L.Ed.2d 384 (1960)].

Michigan raised the defenses of the State's interest in attracting employees by favoring its employees through tax benefits and the fact that as a general rule Federal Government retirees receive greater retirement benefits than Michigan's civil service retirees. The Supreme Court held these differences did not prove a substantial difference between the two classes which would justify a discriminatory tax treatment. *Davis*, 103 L.Ed.2d at 905-06. There are equal protection problems with the first argument. Additionally, if Michigan wished to tax retirees receiving high retirement benefits then the State's tax would be based on amount rather than source. Therefore, the United States Supreme Court declared the Michigan income tax statute unconstitutional. *Davis*, 103 L.Ed.2d at 906.

Unfortunately the *Davis* case does not provide any further guidance on what would amount to "significant differences" which justifies different tax treatment. This Court must start with the presumption that the Kansas Income Tax Act (KITA) is constitutional. *Kansas Malpractice Victims Coalition v. Bell*, 243 Kan. 333, 340, 757 P.2d 251 (1988) [citing *Tri-State Hotel Co. v. Londerholm*, 195 Kan. 748, 408 P.2d 877 (1965)]. In order to decide the issue currently before this Court, whether the KITA violates 4 U.S.C. § 111 and the doctrine of intergovernmental tax

immunity, the Court must examine the military non-disability retired pay and compare it to the Kansas state employee retirement system. All branches of the Armed Forces are governed by similar provisions and therefore, for the sake of this analysis this Court will cite to the statutes which regulate the United States Army.

Title 10 of the United States Code includes several provisions which regulate Army retirees: (1) the Regular Army includes retired officers and enlisted men, 10 U.S.C. § 3075(b)(3); (2) retired officers of the Army may wear their uniform while not on active duty, 10 U.S.C. § 772(c); (3) any retired member of the Regular Army is subject to recall to active duty, 10 U.S.C. §§ 688(a) and 3504(a); (4) retired members of the Armed Forces who are entitled to pay are subject to the Uniform Code of Military Justice and court-martial jurisdiction, 10 U.S.C. §§ 802(a) and 817(a); (5) officers and enlisted men may retire after 20 years of service, *see e.g.*, 10 U.S.C. §§ 3911, 3914; (6) during their service, members of the Armed Forces do not make contributions to a retirement or pension fund from which their retired pay is later drawn, *McCarty v. McCarty*, 453 U.S. 210, 214, 101 S.Ct. 2728, 69 L.Ed.2d 589, 594 (1981); (7) military retirees may lose or have their retired military pay reduced if they become an employee of the federal civil service, 5 U.S.C. § 5532.

When considering this system of military retired pay, the United States Supreme Court concluded retired Army officers "are then by law a part of the army." *United States v. Tyler*, 15 Otto 244, 105 U.S. 244, 26 L.Ed. 985 (1881). The Supreme Court further stated:

> It is impossible to hold that men who are by statute declared to be a part of the army, who may wear its uniform, whose names shall be borne upon its register, who may be assigned by their superior officers to specified duties by detail as other officers are, . . ., are still *not* in the military service.

Tyler, 105 U.S. at 246, 26 L.Ed. at 986. (Emphasis in original).

The plaintiffs argue that *Tyler* should not bear on the outcome of this case because the decision is over one hundred years old. However, *Tyler* has never been overruled and was heavily relied upon in *McCarty v. McCarty*, 453 U.S. 210, 101 S.Ct. 2728, 69 L.Ed.2d 589 (1981). The plaintiff in *McCarty* argued his non-disability military retired pay for twenty (20) years of service in the U.S. Army should not be considered community property under California law for purposes of property distribution in his divorce proceedings. Overruling a decision by the California Court of Appeals, the United States Supreme Court agreed with the plaintiff. The Supreme Court concluded "that military retired pay is reduced compensation for reduced current services." *McCarty*, 69 L.Ed.2d at 599. The Court found the California community property law threatened grave harm to "clear and substantial" federal interests which gave the United States Supreme Court through the Supremacy Clause, U.S. Const., art. VI, cl. 2, authority to override the California law.

In contrast to the military retired pay system, the Kansas Public Employees Retirement Systems (KPERS) puts no requirements upon its retirees. The normal retirement age for a KPERS member is 65 years. K.S.A. § 74-4914(1) (Supp. 1989). Normal retirement may also occur at "age 60 with the completion of 35 years of credited service or at any age with the completion of 40 years of credited service." *Id.* In order to receive any KPERS retirement benefits, the member must have worked at least 10 years and must be at least 55 years of age. K.S.A. § 74-4914(5) (Supp. 1989). If a KPERS member should opt to retire before age 65 the amount of the benefits will be lowered thereby penalizing early retirement. K.S.A. § 74-4915(2) (Supp. 1989). KPERS members pay 4% of their compensation or wage into the KPERS fund. This contribution is credited to the member's individual account with annual interest. K.S.A. § 74-4919(a) (1985). If the employer is the State of Kansas, the employer contributes 3.1% of the employee's wage to the employee's individual account. K.S.A. § 74-49205 (Supp. 1989). Other

KPERS employers contribute 2% of the employee's wage. *Id.* These contributions, by the employee and employer, are made at the time of the worker's employment and are drawn from when the retirement benefits are paid out. Other than staying alive, no requirements or restrictions are placed on a retired KPERS members. *See* Kansas Public Employees Retirement Systems, K.S.A. § 74-4901 *et seq.*

After examining the military non-disability retired pay which is taxed by KITA and KPERS which is exempt from tax under KITA, this Court finds there are substantial differences between the two classes which justifies the disparate tax treatment. Therefore, this Court holds the Kansas Income Tax Act is not unconstitutional nor in violation of 4 U.S.C. § 111. Viewed in toto the military retired system is unique to other retirement systems, especially in light of the fact that military retirees are subject to recall and during active service do not contribute to their retired pay. The absence of contribution during active service by military retirees or by their employer, the Federal Government, is consistent with the *Tyler* and *McCarty* decisions which state military retired pay is reduced compensation for reduced current services.

Plaintiffs argue that the characterization of military retired pay of *Tyler* and *McCarty* should not apply due to the enactment of the Uniform Services Former Spouses Protection Act, 10 U.S.C. § 1408 and its Kansas equivalent K.S.A. § 23-201(b). After the *McCarty* decision, Congress passed the Uniform Services Former Spouses Protection Act which permits States to treat military retired pay as marital property for purposes of marital dissolution. This enactment was a policy decision by Congress and designed to treat former spouses of military retirees more equitably. In 1987, Kansas amended its Married Persons Act to treat military retired pay as marital property for purposes of divorce, separate maintenance, and annulment. K.S.A. § 23-201 (1988). Prior to this amendment, Kansas had held that military retired pay was not marital property and was nothing more than a future stream of income which will cease at the death of the

retiree. *Grant v. Grant*, 9 Kan.App.2d 671, 676, 685 P.2d 327 (1984) [citing *Powell v. Powell*, 231 Kan. 456, 648 P.2d 218 (1982)].

This Court agrees with the defendants that while the Uniform Services Former Spouses Protection Act permitted States to treat military retired pay as marital property, it did not change the legal characterization of military retired pay for any other purpose. *See also Cornetta v. U.S.*, 851 F.2d 1372, 1382 n.3 (Fed. Cir. 1988) ("the legislation did not affect the characterization of military retired pay as reduced compensation for reduced current services"). Plaintiffs argue the Supremacy Clause applies to the case at bar and therefore, this Court must find the KITA unconstitutional under *Davis* and 4 U.S.C. § 111. Certainly the Supremacy Clause applies, however, this Court finds that due to the United States Supreme Court's characterization of military retired pay as reduced compensation for reduced current services the KITA must be found constitutional.

Plaintiffs have also brought to the attention of this Court decisions from other state courts which have addressed actions brought by military retirees resulting from the *Davis* decision. *See e.g., Hackman v. Director of Revenue*, 771 S.W.2d 77 (*cert. denied* 110 S.Ct. 718) (Mo. banc 1989); *Bohn v. Waddell*, 164 Ariz. 74, 790 P.2d 772 (1990). These decisions, which held various States taxation of military retired pay was unconstitutional, are not controlling and this Court is not persuaded by them.

The Court has considered all other issues raised by the parties and finds them to be without merit.

CONCLUSION

The Court finds the Kansas Income Tax Act to be constitutional. Plaintiffs' Motion for Summary Judgment on the Question of Liability is denied.

This action does not involve a genuine issue as to any

material fact and therefore, the Court grants summary judgment to the defendants on its own motion. *Phillips v. Carson*, 240 Kan. 462, syl. 3, 731 P.2d 820 (1987).

In light of the findings of the Court, defendants' request for summary judgment on the issue of whether the defendants can be held liable under 42 U.S.C. § 1983 is moot.

This Memorandum Decision and Order shall serve as the Journal Entry.

Dated this 31st day of October, 1990.

Adrian J. Allen
Judge of the District Court

* * * * * * * *

IN THE DISTRICT COURT OF
SHAWNEE COUNTY, KANSAS
DIVISION 4

NOTICE OF APPEAL

Filed October 31, 1990
[Caption Omitted in Printing]

Pursuant to the provisions of K.S.A. 60-2101(a) and Kansas Supreme Court Rule 2.02, notice is hereby given that all named Plaintiffs and Intervenor/Plaintiff in Case No. 89-CV-666 and all named Plaintiffs in Case No. 89-CV-1100, for themselves and on behalf of the Plaintiff Class designated by Journal Entry filed December 19, 1989, appeal the Memorandum Decision and Order issued by this Court on October 31, 1990 to the Court of Appeals of the State of Kansas.

* * * * * * * *

Supreme Court, U.S.
FILED
JAN 10 1992
OFFICE OF THE CLERK

No. 91-611

IN THE SUPREME COURT OF THE UNITED STATES
October Term, 1991

KEYTON E. BARKER AND PAULINE BARKER, *ET AL.*,
PETITIONERS,

VS.

STATE OF KANSAS, *ET AL.*,
RESPONDENTS.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF KANSAS

BRIEF FOR PETITIONERS

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QUESTION PRESENTED

WHETHER THE KANSAS INCOME TAX ACT VIOLATES CONSTITUTIONAL OR STATUTORY PRINCIPLES OF INTERGOVERNMENTAL TAX IMMUNITY BY FAVORING RETIRED EMPLOYEES OF THE STATE AND ITS POLITICAL SUBDIVISIONS OVER RETIRED OFFICERS AND EMPLOYEES OF THE UNITED STATES ARMED FORCES.

PARTIES TO THE PROCEEDING

The parties to the proceeding in the Kansas Supreme Court were: (1) Petitioners Keyton Barker and Pauline Barker; William Richards, Sr. and Ollun E. Richards; Andrew J. Peele; Clarence Wolf and Flora B. Wolf; John G. Fowler and Carol B. Fowler; Leonard W. Williams and Loneta S. Williams; Anthony E. Corcoran; William J. Lober, Jr. and Marjorie E. Lober; Roger W. Clay and Betty J. Clay; Roger J. Olson and Nancy W. Olson; Leland W. Keister, Jr. and Patricia K. Keister; and Edward F. Kellogg and Renata O. Kellogg, for themselves and all others similarly situated;* and (2) Respondents State of Kansas; Kansas Department of Revenue; Secretary of Revenue of the State of Kansas; and Director of Taxation of the State of Kansas.

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* Petitioners and their counsel were designated by the district court to represent a certified class which consists of approximately 14,000 federal military retirees [and, where applicable, their joint taxpayer spouses] who have been subject to Kansas state income taxation during one or more tax years from 1984 through 1989. *See* J.A. at 50, 53. Petitioners were Appellants in the proceedings before the Kansas Supreme Court.

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OPINIONS BELOW

The opinion of the Kansas Supreme Court [Pet. App. at 1a-35a] is reported at 249 Kan. 186, 815 P.2d 46 (1991). The Memorandum Decision and Order of the District Court of Shawnee County, Kansas [Pet. App. at 36a-46a] is unreported.

JURISDICTION

The judgment of the Kansas Supreme Court was entered on July 12, 1991. Pet. App. at 3a. The petition for a writ of

certiorari was filed on October 10, 1991, and it was granted on November 27, 1991. 112 S.Ct. 576. The jurisdiction of this Court rests upon 28 U.S.C. § 1257(a).

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED

1. Pertinent text from the supremacy clause, U.S. Const., art. VI, cl. 2, is set forth in the Petition at 2.

2. The pertinent text of 4 U.S.C. § 111 provides:

> The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States . . . by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.

3. The pertinent text of Kansas statutes and regulations is set forth in Petition Appendix C at 47a-60a.

STATEMENT

In *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (Mar. 28, 1989), this Court applied settled principles of intergovernmental tax immunity to invalidate a Michigan income tax exemption scheme which favored retired state and local employees over retired federal employees. *Id.* at 817. Petitioners allege that the Kansas income tax exemption scheme suffers from these same constitutional infirmities by favoring retired state and local employees over retired members of the United States Armed Forces.

The Kansas Income Tax Act [Kan.Stat.Ann. § 79-3201 *et seq.* ("KITA")], utilizes federal adjusted gross income as the starting point for determining an individual's state income tax

liability. Kan.Stat.Ann. § 79-32,117(a) (Supp. 1990).[1] Since federal adjusted gross income includes "[a]nnuities" and "[p]ensions" without regard to source, 26 U.S.C. § 61(a)(9) and (11), all types of nondisability retirement benefits paid by federal, state and local governments would be taxable under Kan.Stat.Ann. § 79-32,117(c) (Supp. 1990).

In accordance with Kan.Stat.Ann. § 79-32,117(c), all retirement benefits paid by the State and its political subdivisions are excluded from Kansas adjusted gross income through exemptions identified by the source of compensation. *See* Kan.Stat.Ann. § 79-32,117(c)(ii), (ix), and (xiii) (Supp. 1990).[2] With respect to retirement benefits paid by the United States, however, this statute exempts benefits from only two specified federal sources: "[a]mounts received as annuities under the federal civil service retirement system, from the civil service retirement and disability fund," Section 32,117(c)(vii); and "[a]mounts

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1 Federal "adjusted gross income" consists of gross income [as defined in 26 U.S.C. § 61(a)] minus specified deductions. 26 U.S.C. § 62 (1988).

2 Most benefits paid to retired employees of Kansas and its political subdivisions are exempt as "amounts received which are included in federal adjusted gross income but which are specifically exempt from Kansas income taxation under the laws of the state of Kansas." Kan.Stat.Ann. § 79-32,117(c)(ii) (Supp. 1990). *See* Kan.Stat.Ann. § 12-111a (1982), § 12-5005 (Supp. 1990), § 13-14a10 and § 14-10a10 (1982) [exempting benefits paid to retired policemen and firemen under local retirement plans]; Kan.Stat.Ann. § 20-2618 (Supp. 1990) [exempting benefits paid under the retirement system for state judges]; Kan.Stat.Ann. § 72-1768a and § 72-17,122 [exempting benefits paid under the school employee's supplemental retirement system]; Kan.Stat.Ann. § 74-4923(b) (Supp. 1990) [exempting retirement benefits paid under the Kansas Public Employees Retirement System ("KPERS") and Kansas Police and Fireman's Retirement System ("KP&F")]; Kan.Stat.Ann. § 74-4978g (Supp. 1990) [exempting highway patrol pension fund benefits payable under KP&F]; Kan.Stat.Ann. § 74-49,105 [exempting benefits paid under the official court reporters retirement system]. *See also* Kan.Stat.Ann. § 79-32,117(c)(ix) [exempting benefits paid to retired city employees] and § 79-32,117(c)(xiii) (Supp. 1990) [exempting benefits paid to retired employees of boards of public utilities].

received by retired railroad employees as a supplemental annuity under the provisions of 45 U.S.C. 228b(a) and 228c(a)(1) *et seq.*," Section 32,117(c)(vii).[3] All other federal retirement benefits, including military retired pay, are subject to Kansas income taxation.[4]

Petitioners are designated representatives of a class of approximately 14,000 retired members of the United States Armed Forces [and, where applicable, their joint taxpayer spouses] whose military retired pay has been subject to Kansas income taxation during one or more tax years from 1984 through 1989. J.A. at 53, 56; Pet. App. at 6a. On April 17, 1989, in the wake of *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989), several named Petitioners initiated two class actions alleging that the Kansas income tax scheme violates 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity because it discriminates in favor of state and local government retirement

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[3] Retired members of the United States Armed Forces "62 years of age and older"" are "entitled to claim a tax credit in an amount of $120" against the Kansas income tax on their federal military retirement benefits. Kan.Stat.Ann. § 79-32,111b(a) (1989).

[4] In addition to military retired pay, Kansas also taxes the retirement benefits paid by the United States to: Public Health Service ["PHS"] retirees paid under 42 U.S.C.A. § 212 (West 1991); National Oceanic and Atmospheric Administration ["NOAA"] retirees paid under 33 U.S.C.A. § 853o (West 1986 and Supp. 1991); Central Intelligence Agency ["CIA"] retirees paid under the Central Intelligence Agency Retirement and Disability Act of 1964 for Certain Persons, Pub. L. 88-643, 78 Stat. 1043 (Oct. 13, 1964), as amended [50 U.S.C.A. § 403 note (West 1991)]; Foreign Service retirees paid from the Foreign Service Retirement and Disability Fund, 22 U.S.C.A. § 4041 *et seq.* (West 1990 and Supp. 1991); retired Justices and Judges of the United States paid under 28 U.S.C.A. § 371 (West 1968 and Supp. 1991); retired Claims Court judges paid under 28 U.S.C.A. § 178 (West Supp. 1991); and retired bankruptcy judges and magistrates paid under 28 U.S.C.A. § 377 (West Supp. 1991). *See* Kan.Stat.Ann. § 79-32,117(c) [no exemption for retirement benefits paid from these federal sources]; Pet. App. at 29a.

benefits. J.A. at 3-6, 9-12.[5] All Petitioners paid Kansas income taxes on their military retired pay during one or more tax years at issue. R. at 1055, 1069, 1083, 1109, 1129-1130, 1138, 1148, 1152-1153, 1164, 1172, 1181-1182, 1190.

On February 23, 1990, Petitioners moved for summary judgment on the question of liability, contending in relevant part that KITA unconstitutionally discriminates in favor of state and local government retirees and against federal military retirees based on the source of their retirement compensation. J.A. at 57. In opposition, Respondents argued that differential taxation of military retired pay under KITA is constitutional because it is directly related to and justified by substantial differences between the classes of retirees. R. at 1437-68.

On October 31, 1990, the district court rejected Petitioners' constitutional challenge and entered judgment *sua sponte* upholding the Kansas differential tax scheme. Pet. App. at 36a-46a. Relying primarily upon federal decisions which have characterized military retired pay as current compensation for purposes unrelated to taxation, the court reasoned that "there are substantial differences" between the classes which "justifies the disparate tax treatment" of military retirees. *Id.* at 41a-43a. The district court accordingly held that "the Kansas Income Tax Act is not unconstitutional nor in violation of 4 U.S.C. § 111." *Id.* at 44a-45a. Petitioners timely appealed. J.A. at 70.[6]

On July 12, 1991, the Kansas Supreme Court affirmed in

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[5] These lawsuits were subsequently consolidated in the District Court of Shawnee County, Kansas [J.A. at 33-34], and certified upon Petitioners' motion as a class action [J.A. at 48-49, 56]. Since *Barker* became the lead case following consolidation, all citations to the record of proceedings below rely upon the *Barker* Record.

[6] This case was later transferred from the Kansas Court of Appeals to the Kansas Supreme Court under the provisions of Kan.Stat.Ann. § 20-3017. Pet. App. at 5a; *see also* Kansas Supreme Court Order (filed Nov. 19, 1990).

a published opinion upholding the state's discriminatory tax scheme. Pet. App. at 1a-35a. In the court's view, differential taxation of military retirement benefits in Kansas is directly related to and justified by the "federal cases holding that military retirement pay is reduced compensation for reduced current services" and the "noncontributory" nature of the military retirement system. Pet. App. at 1a, 3a, 30a, 26a. Based on this reasoning, the Kansas Supreme Court held that the "discriminatory tax" is constitutional because it satisfies the requirements of *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989). Pet. App. at 35a, 1a and 3a.

SUMMARY OF THE ARGUMENT

The Kansas Income Tax Act [Kan.Stat.Ann. § 79-3201, *et seq.* ("KITA")] violates controlling principles of intergovernmental tax immunity by giving preferential treatment to retired employees of the State and its political subdivisions over retired officers and employees of the United States Armed Forces because of the source of their retirement pay or compensation. *See Davis v. Michigan Dept. of Treasury*, 489 U.S. at 817. The statute which creates the discriminatory classification in issue, Kan.Stat.Ann. § 79-32,117 (Supp. 1990), does not discriminate against federal military or civilian retirees because of any significant differences in their compensation or retirement systems; rather, it discriminates against them because they receive retirement pay from the Federal Government instead of the State or its political subdivisions. The offensive nature of this statute is vividly illustrated by the reality that these federal military and civilian retirees "would not be taxed at all if [their employer] were the State or one of its political subdivisions instead of the Federal Government." *Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U.S. 376, 382 (1960).

While Kansas generally taxes the income of its residents, all retirement benefits paid by the State and its political subdivisions are exempt from such taxation by source of compensation. *See* Kan.Stat.Ann. § 79-32,117(c)(ii), (ix), (xiii)

(Supp. 1990); *supra* at 3 and n. 2. However, pursuant to Kan.Stat.Ann. §§ 79-32,116 (1989) and 79-32,117(a) (Supp. 1990), all retirement benefits paid by the United States, including military retired pay, are subject to taxation except civil service annuities and railroad retirement supplemental annuities, which are exempt under Kan.Stat.Ann. §§ 79-32,117(c)(vii) and (viii) (Supp. 1990).

Since "Kansas income tax exemptions" for retirement income "are identified strictly by source" of compensation, Pet. App. at 26a, the Kansas tax system unlawfully favors all retired employees of the State and its political subdivisions over all retired officers and employees of the United States, including military retirees, who receive nondisability retirement benefits from any federal source which is not specifically recognized as the basis for an exemption.[7] This differential tax scheme discriminates against all such retired federal officers and employees "because of the source" of their "pay or compensation" and, therefore, violates the nondiscrimination clause of 4 U.S.C. § 111 as well as the constitutional doctrine of intergovernmental tax immunity. *See Davis*, 489 U.S. at 810, 813-814, 817.[8]

The Kansas Supreme Court's attempt to justify this "discriminatory tax" [Pet. App. at 35a] on the basis that military

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[7] While exemptions for federal civil service annuities and railroad retirement supplemental annuities are exceptions to the general taxability of federal retirement benefits under KITA which "reduce the extent of the discrimination created by" the Kansas tax scheme, "they obviously do not eliminate it." *Cf. Phillips Chemical Co.*, 361 U.S. at 381 n. 6.

[8] *Cf. Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392, 397-399 (1983) [invalidating a Tennessee bank tax which impermissibly discriminated "in favor of securities issued by Tennessee and its political subdivisions and against federal obligations * * * * by including in the tax base income from federal obligations while excluding income from otherwise comparable state and local obligations."]; *Phillips Chemical Co.*, 361 U.S. at 383-387 [invalidating a Texas lease tax which impermissibly taxed lessees of federal property while exempting lessees of exempt property owned by the State and its political subdivisions].

retirees receive current compensation and participate in a noncontributory retirement system is unavailing. Although inconsistent tax treatment may be permissible if it is "directly related to and justified by 'significant differences between the two classes,'" *Davis*, 489 U.S. at 816 [citation omitted], the Kansas court reached an erroneous conclusion, in part, because it did not examine "'the whole tax structure of the state'" or "focus on the nature of the classification" erected by the statutory tax scheme. *Phillips Chemical Co.*, 361 U.S. at 383 [quoting *Tradesmens Nat. Bank of Oklahoma City v. Oklahoma Tax Commission*, 309 U.S. 560, 568 (1940)]. When viewed in its entirety, however, the applicable tax structure is solely dependent upon "source" of retirement pay and this single statutory classification does not account for any alleged differences in the nature or funding of retirement compensation. Kansas accordingly discriminates against many forms of federal civilian retirement pay -- none of which is current compensation and most of which is funded through contributory retirement systems -- under the same source-related classification which results in the taxation of military retired pay. While KITA operationally creates only a single classification as the basis of differential treatment, the opinion below draws unwarranted distinctions which are neither recognized by the statutory scheme nor uniformly applicable to all affected government employees.

The Kansas Supreme Court further erred in relying upon nontax cases such as *McCarty v. McCarty*, 453 U.S. 210 (1981), and *United States v. Tyler*, 105 U.S. 244 (1881), to conclude that military retired pay must be characterized and treated for income tax purposes as "reduced current compensation for current reduced services." Pet. App. at 30a, 17a-24a. Regardless of its characterization or treatment for other distinct purposes, military retired pay is taxable under 26 U.S.C. § 61(a)(11) (1988) as ordinary pension income when received. *See McCarty*, 453 U.S. at 214 n. 7 [citing 26 U.S.C. § 61(a)(11); 26 C.F.R. § 1.61-11 (1980)]. Because Kan.Stat.Ann. § 79-32,117(a) incorporates this federal tax treatment of military retired pay in defining the State tax base, military retired pay is taxable under KITA as "pension"

income, 26 U.S.C. § 61(a)(11), rather than as wages, salaries or other compensation for current service. The specific statutory basis for taxing military retired pay as pension income, therefore, rejects compensation for current service as a bona fide reason or justification for discrimination.

In addition to the treatment of military retired pay in the same manner as "pensions" under 26 U.S.C. § 61(a)(11), other provisions of federal and state law relevant to taxation consistently treat military retired pay in the same manner as other pensions.[9] It is, therefore, inconceivable that differential treatment under KITA is directly related to any material differences in nature of military retired pay or that Congress has consented to such discriminatory taxation. Although military retired pay is not significantly different in character, at least for tax purposes, from other forms of retirement income, *cf. McCarty*, 453 U.S. at 223 n. 16 [military retired pay bears features of deferred compensation], the Kansas tax scheme violates 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity by discriminating against federal military retirees because of the "source" of their pay or compensation.

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[9] For example, the Federal Insurance Contributions Act ["FICA"] levies a tax on "wages" for employment, but it does not tax military retired pay or any other form of pension income. *See* 26 U.S.C.A. §§ 3121(a)(5), (i)(2), (m) and (v)(3) (West Supp. 1991). Similarly, although wages for employment are generally subject to involuntary income tax withholding, state income taxes may not be withheld from military retired pay unless the taxpayer "voluntarily requests such withholding in writing." *See* 10 U.S.C.A. § 1045(a) (West Supp. 1991). Under the Internal Revenue Code, military retirees who fund survivor annuities through reductions in retired pay are also extended the same tax treatment as civil service retirees and other retirees under qualified pension plans. *See* 26 U.S.C. § 122(a) (1988) [gross income does not include such reductions in retired pay]; H.R. Rep. No. 1118, 89th Cong., 1st Sess. 4-5 (1965). Likewise, contributions to an Individual Retirement Account ["IRA"] made with military retired pay do not qualify for an IRA deduction because it is treated as pension income. *See* 26 U.S.C. § 219(f)(1) (Supp. 1989); Weinstein, 6 *Mertens Law of Federal Income Taxation* § 25C.12 at 58 (1988); Pet. App. at 24a-25a.

The Kansas Supreme Court also erroneously suggested that the "noncontributory" nature of the military retirement system might justify differential treatment of federal military retirees because "[t]he federal government's method of funding" prevents Kansas from taxing any portion of their benefits before receipt. Pet. App. at 26a. If Kansas truly intended to discriminate on this basis rather than by source of compensation, state retirement benefits funded without any taxable employee contributions would be taxed upon receipt, but they are exempt. *See* Kan.Stat.Ann. § 74-4923(b) and § 74-4925(1)(a) and (4) (Supp. 1990), *with Davis*, 489 U.S. at 817. Likewise, all federal retirement benefits funded with employee contributions would be exempt upon receipt, but they are not. *See* Kan.Stat.Ann. § 79-32,117(a) and (c) (Supp. 1990). *See Davis*, 489 U.S. at 817. On the other hand, differential taxation of federal retirement pay on the basis that the officers or employees did not contribute to any retirement fund before retirement would clearly violate 4 U.S.C. § 111; this purported rationale is merely another way of stating that discrimination is based on the fact that the United States is the exclusive "source of the pay or compensation."[10] Moreover, the manner in which the United States funds its retirement system does not implicate any proper domestic concerns of Kansas, and any attempt to rely upon this federal policy choice to justify tax discrimination against military retirees would impermissibly trench upon or interfere with the constitutional prerogatives of Congress. *Cf. McCarty*, 453 U.S. at 232-236 *with Phillips Chemical Co.*, 361 U.S. at 385.

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10 While differences in funding methods is not the reason for discrimination under KITA, it should also be recognized that employer contributions made by the State and its political subdivisions, as well as the investment growth in their retirement plans, are never subject to Kansas income taxation. Therefore, the blanket exclusion of state and local retirement benefits from the Kansas tax base unjustifiably exceeds any limited exemption which may be necessary to avoid double taxation of employee contributions.

ARGUMENT

THE KANSAS INCOME TAX ACT VIOLATES GOVERNING PRINCIPLES OF INTERGOVERNMENTAL TAX IMMUNITY BY FAVORING RETIRED EMPLOYEES OF THE STATE AND ITS POLITICAL SUBDIVISIONS OVER RETIRED OFFICERS AND EMPLOYEES OF THE UNITED STATES ARMED FORCES.

Under codified principles of intergovernmental tax immunity, state and local taxing authorities are "unmistakably" prohibited from imposing taxes which discriminate against active and retired officers or employees of the United States "because of the source" of their "pay or compensation." 4 U.S.C. § 111. *See Davis*, 489 U.S. at 810. This statutory prohibition "closely parallels" and "is coextensive with" the constitutional doctrine of intergovernmental tax immunity which bars "taxes that 'operat[e] so as to discriminate against the Government or those with whom it deals.'" *Davis*, 489 U.S. at 812-813 [quoting *United States v. City of Detroit*, 355 U.S. 466, 473 (1958)]. Therefore, "'[t]he imposition of a heavier tax burden on [those who deal with one sovereign] than is imposed on [those who deal with the other]'" violates these governing principles unless "the inconsistent tax treatment is directly related to, and justified by, 'significant differences between the two classes.'" 489 U.S. at 815-816 [quoting *Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U.S. 376, 383-385 (1960)].

In evaluating whether a state tax scheme unlawfully discriminates against the United States or those with whom it deals, this Court has made clear that reviewing courts must examine "'the whole tax structure of the state'" and "focus on the nature of the classification" erected by statute. *Phillips Chemical Co.*, 361 U.S. at 383 [quoting *Tradesmens Nat. Bank of Oklahoma City v. Oklahoma Tax Commission*, 309 U.S. 560, 568 (1940)]. Such examination is necessary to identify the actual basis for differential treatment and to insure that proffered rationales for inconsistent treatment are not merely pretexts for impermissible

discrimination. *See Davis*, 489 U.S. at 816-817; *Phillips Chemical Co.*, 361 U.S. at 383-385. Indeed, the elevated standard of justification required to protect the interests of the United States would be substantially emasculated without these objective limitations on the proper form of inquiry.

Respondents expressly concede "that military retirees are entitled to receive the protection of 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity." Respondents' Brief in Opposition at 6, 11. Respondents also acknowledge that the State of Kansas levies an income tax on federal military retired pay while exempting retirement benefits paid by the State and its political subdivisions. *Id.* at 4. Therefore, the dispositive issue presented on writ of certiorari is whether the Kansas differential income tax scheme truly complies with the direct relationship and justification requirements articulated in *Davis*, 489 U.S. at 816, and *Phillips Chemical Co.*, 361 U.S. at 383-385.

In *Davis*, this Court struck down a differential exemption scheme under the Michigan Income Tax Act which "violate[d] principles of intergovernmental tax immunity by favoring retired state and local government employees over retired federal employees." 489 U.S. at 817. Given the statutory manner in which Michigan exempted retirement income by source of compensation, the retirement benefits of retired state and local government employees were exempt from state taxation while the benefits received by retired federal employees were not. *Id.* at 806 and n.2. However, Congress unmistakably forbids state taxation which discriminates against retired federal officers or employees "because of the source of the pay or compensation." 4 U.S.C. § 111. *See Davis*, 489 U.S. at 812. Reasoning that Michigan's tax system "discriminate[d] on the basis of the source of [retirement] benefits," and that "[t]he State's interest in adopting the discriminatory tax" cannot justify differential treatment, *Davis* concluded that Michigan's exemption scheme offended controlling precepts of federal law. *Id.* at 816-817. This analysis is equally applicable here.

A. All Government Retirees Are Similarly Situated For Purposes of Taxation and "Presumably Should be Taxed Alike."

Despite the importance of determining whether federal, state and local government retirees are "similarly situated" for tax purposes, the opinion below does not directly address or resolve this initial issue. Instead, the Kansas Supreme Court erroneously viewed the threshold question of whether the classes are "similarly situated" as synonymous with the ultimate question of whether differential taxation is justified by "significant differences" between the classes. *See, e.g.*, Pet. App. at 15a-17a. This mistaken interpretation, however, directly conflicts with the analytical framework applied in *Phillips Chemical Co.*, 361 U.S. at 381-385, and it disregards the presumption of equal taxation applicable in cases involving intergovernmental tax immunity. *Id.* at 381.

As a threshold matter, Petitioners submit that all retired officers or employees of the United States are "similarly situated" with state and local government retirees for purposes of the tax immunity doctrine. Upon retirement, each civilian and military officer or employee: leaves active government service; acquires "retired" status; and receives nondisability retirement pay based on years of past service and highest qualifying rank or level of compensation attained.[11] Likewise, no such retired officer or

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[11] "Members of the Armed Forces who serve for a specified period, generally at least 20 years, may retire with retired pay. 10 U.S.C. § 3911 *et seq.* (1982 ed. and Supp. V) (Army); § 6321 *et seq.* (Navy and Marine Corps) (1982 ed. and Supp. V); § 8911 *et seq.* (Air Force) (1982 ed. and Supp. V). The amount of retirement pay a veteran is eligible to receive is calculated according to the number of years served and the rank achieved." *Mansell v. Mansell*, 490 U.S. 581, 583 (1989). *See* 10 U.S.C.A. §§ 1401, 1406 and 1407 (West 1983 and Supp. 1991).

Federal civil servants who meet certain combined age and years of service requirements may retire and immediately begin receiving retirement benefits. *See* 5 U.S.C.A. § 8336 (West 1980 and Supp. 1991). For example,

employee continues to receive salary or wages from the government based on any active or affirmative duties which must be performed in retirement. *See, e.g.*, 37 U.S.C. § 204(a), § 402(a), § 403(a) (1988) [military retirement terminates the right to active duty pay and allowances]. All government retirees are, therefore, "similarly situated" since they share these common characteristics and they *"presumably should be taxed alike."* *Phillips Chemical Co.*, 361 U.S. at 381 [emphasis added].[12]

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federal employees who complete "20 years of service as a law enforcement officer or firefighter" may retire at 50 years of age with a full retirement annuity. 5 U.S.C.A. § 8336(c)(1) (West 1980). For all federal civil servants, "the amount of benefits received in retirement is based and computed upon the individual's salary and years of service. 5 U.S.C. § 8339(a) [5 U.S.C.S. § 8339(a)]." *Davis*, 489 U.S. at 808. Other federal retirement systems for civilian employees of the United States not covered by the federal civil service retirement system also share these same features.

By comparison, employees of Kansas and its political subdivisions may generally retire with full benefits after at least 10 years of service upon reaching a specified age or at any age with the completion of 40 years of service. *See, e.g.*, Kan.Stat.Ann. § 74-4914(1) (Supp. 1990). For example, police officers and firefighters may retire with full benefits at age 55 following 20 years of service or at age 50 following 25 years of service. Kan.Stat.Ann. §§ 74-4957(1) and (3), 74-4955a(1) and 74-4957a(1) (Supp. 1990). For all such state and local government retirees, the amount of benefits received in retirement is based on and calculated in accordance with years of service and final average salary. *See, e.g.*, Kan.Stat.Ann. §§ 74-4915(1) and 74-4958(1) (Supp. 1990).

12 As this Court observed in *Davis*, 4 U.S.C. § 111 was enacted as part of the Public Salary Tax Act of 1939 to "impose federal income tax on the salaries of all state and local government employees" and to authorize the imposition of nondiscriminatory state taxes on the pay or compensation of all federal officers and employees. 489 U.S. at 810-812. *See also* S. Rep. No. 112, 76th Cong., 1st Sess. 1 (1939) ["Title I of the bill subjects to Federal income tax for taxable years beginning after December 31, 1938, the compensation of all State and local officers and employees and grants consent to the States to tax the compensation received after December 31, 1938, by Federal officers and employees."]. By this simultaneous action, Congress plainly intended all federal, state and local government employees to be equally subject to the burdens of both federal and state income taxation. *Davis*, 489 U.S. at 812 [Congress was "concerned that considerations of fairness demanded equal tax treatment for state

"Because 'the Government's interests must be weighed in the balance,'" the presumption that federal retirees are entitled to equal tax treatment places a substantial burden on state taxing authorities to establish that differential taxation is "directly related to and 'justified by significant differences'" between the favored and the disfavored classes of taxpayers. *Davis*, 489 U.S. at 815-817; *Phillips Chemical Co.*, 361 U.S. at 383-385. In direct conflict with these settled principles, however, the opinion below improperly applied a state presumption that KITA's differential taxation of federal military retirees is constitutional and resolved "all doubts . . . in favor of its validity." Pet. App. at 9a. *Cf. King v. St. Vincent's Hospital*, No. 90-889, slip op. at 6 n.9 (U.S., filed Dec. 16, 1991) ["provisions for benefits to members of the Armed Services are to be construed in the beneficiaries' favor," citing *Fishgold v. Sullivan Drydock & Repair Corp.*, 328 U.S. 275, 285 (1946)].

B. The Kansas Tax Scheme Is Substantially Similar to the Michigan Scheme Invalidated in *Davis*.

Like Michigan's offensive tax scheme, KITA "defines taxable income in a manner that excludes all retirement benefits received from the State or its political subdivisions, but includes most other forms of retirement benefits." *Davis*, 489 U.S. at 806. *See* Kan.Stat.Ann. § 79-32,116 (1989); Kan.Stat.Ann. §§ 79-32,117(a) and (c)(ii), (ix), (xiii) (Supp. 1990); Pet. App. at 7a-8a, 29a. However, all retirement benefits paid by the United States -- including military retired pay -- are subject to tax except civil

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and federal employees"]. *See also*, 84 CONG. REC. 1306 (1939) (statement of Rep. Cochran) [the Act is an "effort to equalize the tax burdens by requiring State employees to pay a Federal income tax and the Federal employees to pay State income tax"]; *Id.* at 1313 (statement of Rep. Disney) ["The prime object of the bill is . . . to equalize taxes"]; *Id.* at 1318 (statement of Rep. Dingell) ["the bill provides for reciprocal taxation on an equality basis"]; *Id.* at 1329 (statement of Rep. Cooper) ["the consent of Congress to tax Federal employees * * * * is based upon equality and fairness"]. Therefore, members of the class of government retirees are similarly situated for tax purposes.

service annuities and railroad retirement supplemental annuities, which are exempt under Kan.Stat.Ann. §§ 79-32,117(c)(vii) and (viii) (Supp. 1990). Since all "Kansas income tax exemptions are identified strictly by source" of retirement pay or compensation, Pet. App. at 26a, the differential exemption scheme erected by KITA -- which discriminates between retired government employees solely because of the "source" of their compensation -- is materially indistinguishable from Michigan's unlawful exemption scheme invalidated in *Davis*. *Cf.* Kan.Stat.Ann. § 79-32,117(c) (Supp. 1990) *with* Mich. Comp. Laws Ann. §§ 206.30(1)(f)(i) and (iv) (Supp. 1988).[13]

The Kansas Supreme Court considered the "net result" of this source-related Kansas exemption scheme to be that "benefits paid to federal civil service, railroad, state and local government retirees are exempt from Kansas income tax while benefits paid to military retirees are not." Pet. App. at 10a-11a. This comparison, however, obscures the true nature and extent of the differential taxation at issue. Because the opinion below did not follow the unequivocal mandate to examine "'the whole tax structure of the state'" and "focus on the nature of the classification," *Phillips Chemical Co.*, 361 U.S. at 383 [citation omitted], its selective approach ignores the harsh reality that Kansas taxes every federal retiree who receives retirement pay

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[13] While Michigan did not exempt any federal retirement benefits from state income tax, all federal retirees were given a specific deduction of "'not more than $7,500.00'" on each single tax return and "'not more than $10,000.00'" on each joint tax return. *Davis*, 489 U.S. at 806 n.2 [quoting Mich. Comp. Laws Ann. § 206.30(1)(f)(iv) (Supp. 1988)]. Since retired military and civilian employees of the United States are generally required to pay Kansas income tax, without the benefit of comparable deductions, they bear an even greater tax burden than their retired counterparts did under Michigan's unlawful tax scheme. Therefore, while exemptions for federal civil service annuities and railroad retirement supplemental annuities "reduce the extent of the discrimination created by" the Kansas differential tax scheme, "they obviously do not eliminate it." *Cf. Phillips Chemical Co.*, 361 U.S. at 381 n.6 [taxation of certain types of public property owned by Texas and its political subdivisions reduced, but obviously did not eliminate, discrimination against the United States and its lessees].

from any federal source other than the Civil Service Retirement and Disability Fund.

In addition to military retired pay, Kansas also refuses to exempt the retirement pay received by all other federal retirees, including: Public Health Service ["PHS"] retirees paid under 42 U.S.C.A. § 212 (West 1991); National Oceanic and Atmospheric Administration ["NOAA"] retirees paid under 33 U.S.C.A. § 853o (West 1986 and Supp. 1991); Central Intelligence Agency ["CIA"] retirees paid under the Central Intelligence Agency Retirement and Disability Act of 1964 for Certain Persons, Pub. L. 88-643, 78 Stat. 1043 (Oct. 13, 1964), as amended [50 U.S.C.A § 403 note (West 1991)]; Foreign Service retirees paid from the Foreign Service Retirement and Disability Fund, 22 U.S.C.A. § 4041 *et seq.* (West 1990 and Supp. 1991); retired Justices and Judges of the United States paid under 28 U.S.C.A. § 371 (West 1968 and Supp. 1991); retired Claims Court judges paid under 28 U.S.C.A. § 178; and retired bankruptcy judges and magistrates paid under 28 U.S.C. § 377 (West Supp. 1991). *See* Kan.Stat.Ann. § 79-32,117(c) [no exemption for retirement benefits paid from these federal sources]; Pet. App. at 29a. Since these federal retirees are similarly situated with all other government retirees for tax purposes, the treatment of their federal retirement pay under the same statutory classification which discriminates against military retirees cannot be ignored in any objective evaluation of the Kansas source-related exemption scheme.

The opinion below, however, expressly refused to consider the differential tax treatment of these other federal retirees for the stated reason that they do not have "*exactly the same characteristics* as the class of military retirees . . .." Pet. App. at 29a [emphasis added]. This refusal fundamentally conflicts with the command "to determine how other taxpayers *similarly situated* are treated," *Phillips Chemical Co.*, 361 U.S. at 383 [emphasis added], and it impermissibly limits the constitutional inquiry to those government retirees who have "exactly the same characteristics." Since no two classes of federal, state or local

government retirees have "exactly the same characteristics," the Kansas Supreme Court employed an unreasonably narrow standard of review which substantially eviscerates the nondiscrimination clause of 4 U.S.C. § 111 and the constitutional doctrine of intergovenmental tax immunity. If this improper mode of analysis is not repudiated immediately, it may become open season for discrimination against retired federal employees on the basis of purely superficial differences between retirees who are in privity with state and local governments and those who are not. As this Court recently observed, "[t]he danger that a State is engaging in impermissible discrimination against the Federal Government is greatest when the State acts to benefit itself and those in privity with it." *Davis*, 489 U.S. at 815 n.4.[14]

By refusing to consider the disparate treatment of other similarly situated federal retirees, the Kansas Supreme Court also ignored the nature of the classification erected by the Kansas tax statute, *contra Phillips Chemical Co.*, 361 U.S. at 383, which relies exclusively upon the particular government "source" of retirement pay or compensation in determining whether benefits will be excluded from the Kansas tax base. This highly selective approach demonstrates that the Kansas court simply turned a blind eye -- under inappropriate state standards of review -- on patently unlawful discrimination. Although many forms of federal civilian retirement benefits taxed by Kansas are not compensation for service in retirement or derived from noncontributory retirement systems, they are subject to the same disparate treatment under the

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[14] The State of Kansas and its political subdivisions are in privity with all of their active and retired employees who participate in a state or local government retirement system. *See Shapiro v. Kansas Public Employees Retirement System*, 216 Kan. 353, Syl. ¶ 1, 532 P.2d 1081 (1975) ["State retirement systems create contracts between the state and its employees who are members of the system."]. *See also Brazelton v. Kansas Public Employees Retirement System*, 227 Kan. 443, 448-449, 607 P.2d 510 (1980) [the rights to retirement benefits under KPERS and KP&F are contractual in nature]. This continuing contractual relationship also demonstrates that state and local government employees do not sever the connection with their employer upon retirement.

same discriminatory classification as military retired pay. Since the opinion below examined and considered the treatment of all federal, state and local government retirees whose benefits are exempt from Kansas income taxation, its refusal to examine and consider the tax treatment of all federal retirees who are adversely affected by the differential classification is inconsistent, indefensible, and contrary to the classification established by the statute itself.

Nevertheless, comprehensive examination of the Kansas tax structure applicable to all government retirees clearly demonstrates that KITA favors all categories of state and local government retirees over virtually all categories of federal retirees based on the source of their retirement compensation.[15] Kan.Stat.Ann. § 79-32,117 (Supp. 1990) does not discriminate against federal retirees because of any significant differences in their compensation or retirement systems; rather, it discriminates against them solely because they receive retirement pay from the Federal Government instead of the State or its political subdivisions. Indeed, retired officers and employees of the United States whose retirement pay is subject to the Kansas income tax "would not be taxed at all if [their employer] were the State or one of its political subdivisions instead of the Federal Government." *Phillips Chemical Co.*, 361 U.S. at 382. The differential exemption scheme in Kansas is, therefore, substantially similar to the Michigan tax system repudiated by this Court, and it deserves the same fate. *See Davis*, 489 U.S. at 806, 814-817.

C. Differential Taxation of Federal Military Retirees Is Not "Directly Related to" Any Significant Differences Between the Classes of Favored and Disfavored Goverment Retirees.

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15 While source-related exemptions for retired federal civil servants and railway employees may "reduce the extent of the discrimination" created by KITA, "they obviously do not eliminate it." *Cf. Phillips Chemical Co.*, 361 U.S. at 381 n. 6.

Relying upon *Davis* and certain federal cases having nothing to do with taxation or intergovernmental tax immunity, the Kansas Supreme Court concluded that differential taxation of military retirement pay is directly related to its character as "reduced current compensation for reduced current services." Pet. App. at 30a. The opinion below reasoned that there is a "direct relationship" between differential taxation and the alleged nature of retirement pay because "an evenhanded application of the rationale for taxing all members of one class (military retirees) does not result in taxation of some members of the other class (state and local government retirees)." Pet. App. at 28a. These conclusions, however, are patently erroneous and must be rejected.

The direct relationship test mandates that statutory classifications which result in differential taxation must be "based on" significant differences between all members of the favored class of taxpayers and the disfavored class of taxpayers. *Phillips Chemical Co.*, 361 U.S. at 384. This requirement is not satisfied, however, unless the significant differences offered as justification furnish the actual reason for discrimination. *Davis*, 489 U.S. at 816-817. To paraphrase *Davis*, *"[a] tax exemption truly intended to account for differences in retirement benefits would not discriminate on the basis of the source of those benefits [as Kansas does];* rather, it would discriminate on the basis of [asserted differences in retirement benefits]." *Id.* at 817 [emphasis added]. Therefore, a state tax exemption scheme which erects a source-related classification cannot survive scrutiny unless the proffered rationale for discrimination uniformly justifies an exemption for all retirees in the favored class and it uniformly justifies taxation of all retirees in the disfavored class. *Davis*, 489 U.S. at 817; *Phillips Chemical Co.*, 361 U.S. at 383-385.

Notwithstanding the existence of nontax cases such as *McCarty v. McCarty*, 453 U.S. 210 (1981), and *United States v. Tyler*, 105 U.S. 244 (1881), which view military retired pay as reduced current compensation for certain distinct purposes, the opinion below fatally ignores the fact that KITA's source-related classification creates a *single disfavored class* of former federal

officers or employees which includes: all recipients of military retired pay; all retired members of the PHS, NOAA, Foreign Service, and Article III judiciary; certain retired claims court judges, bankruptcy judges and magistrates; and certain retired members of the CIA.[16] The Kansas classification scheme does not, however, recognize or endorse any distinctions -- except source of compensation -- that can be selectively compared in order to justify discrimination. Instead, each member of this class of federal officers and employees receives disfavored tax treatment solely because KITA does not recognize the "source" of their

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16 Claims court judges, bankruptcy judges and magistrates who retire under either the Civil Service Retirement and Disability System [5 U.S.C.A. § 8331 *et seq.* (West 1980 and Supp. 1991)] or the Federal Employees' Retirement System [5 U.S.C.A. § 8401 *et seq.* (West Supp. 1991) ("FERS")] are entitled to an exemption under Kan.Stat.Ann. § 79-32,117(c)(vii) (Supp. 1990) because their retirement pay is received from the "civil service retirement and disability fund." However, Claims Court judges who have retired or elect to retire under 28 U.S.C.A. § 178 (West Supp. 1991) receive retirement pay from the Claims Court Judges Retirement Fund which is fully taxable in Kansas because Kan.Stat.Ann. § 79-32,117(c) does not recognize this federal "source" of retirement pay as the basis for an exemption. Likewise, bankruptcy judges and magistrates who have retired or elect to retire under 28 U.S.C.A. § 377 (West Supp. 1991) receive retirement pay from the Judicial Officers' Retirement Fund which is fully taxable in Kansas because Kan.Stat.Ann. § 79-32,117(c) does not recognize their "source" of retirement pay as the basis for an exemption.

Members of the CIA who retire or elect to retire under FERS in accordance with Title III of the Central Intelligence Agency Retirement Act of 1964 [50 U.S.C.A. § 403 note (West 1991) (Title III, §§ 301 and 307)] receive tax exempt treatment under KITA because their retirement benefits are paid from the "civil service retirement and disability fund." Kan.Stat.Ann. § 79-32,117(c)(vii). However, members of the CIA who retire under Title II of the Act receive retirement pay from the Central Intelligence Agency Retirement and Disability Fund [50 U.S.C.A. § 403 note (Title II, §§ 202 and 211)] which is fully taxable because Kan.Stat.Ann. § 79-32,117(c) does not recognize this federal "source" of retirement pay as the basis for an exemption.

Differential tax treatment of these federal retirees is not merely fortuitous; rather, it highlights the fact that the source of compensation alone is the basis of discrimination.

retirement pay as the basis for an exemption. The Kansas tax system, therefore, impermissibly erects a classification -- based entirely on source -- which uniformly burdens all federal retirees who must pay tax regardless of the nature, characterization or funding of their federal retirement pay. *Cf. Phillips Chemical Co.*, 361 U.S. at 384 [rejecting the State's proffered justification where the offensive tax statute "impose[d] its burdens on all federal lessees" in the disfavored class without regard to alleged differences in leasing activities].

Since many members of the disfavored class undoubtedly receive retirement pay which cannot be characterized as "reduced current compensation for reduced current services," an evenhanded application of this rationale cannot justify the discriminatory classification scheme under KITA. *See Davis*, 489 U.S. at 816-817 [rejecting Michigan's rationale for differential treatment since its uniform application to all members of the favored and disfavored classes would justify an exemption for some retired federal employees and taxation of some retired state employees]. If Kansas truly intended to account for differences in the nature or characterization of retirement pay, it would not discriminate based on the source of payment and it would not tax any federal retirees in the disfavored class who receive deferred compensation. But KITA does both.

In *Davis*, after observing that "the amount of [federal civil service] benefits to be received in retirement is based and computed upon the individual's salary and years of service," this Court expressed "no difficulty concluding that civil service retirement benefits are deferred compensation for past years of service rendered to the Government." 489 U.S. at 808. As a consequence, such federal retirement benefits are squarely entitled to the protection of 4 U.S.C. § 111. *Id.* This analysis reflects a realistic view that, with respect to the nondiscrimination clause of Section 111, retirement compensation "based and computed upon the individual's salary and years of service" is protected, and that federal retirement benefits which bear these essential features are likewise entitled to protection from discrimination "because of the

source of the pay or compensation."

Nevertheless, many forms of federal civilian retirement benefits are taxed under KITA even though they share the essential characteristics of deferred compensation and have never been characterized as compensation for current service. *See, e.g.*, Pub. L. 88-643, Title II, § 221(a), 78 Stat. 1043 (1964), *reprinted in* 50 U.S.C.A. § 403, note, Title II, § 221(a) (West 1991) [retirement annuities under the CIA retirement and disability system are based on each participant's highest average basic salary and years of service]; 22 U.S.C.A. § 4046(a) and § 4071d(b)(2) (West 1990 and Supp. 1991) [Foreign Service retirement benefits for career and non-career members are based on the highest average basic salary received and years of service]; 42 U.S.C.A. § 212(a)(4) and (6) (West 1991) [PHS retired pay is calculated in accordance with basic pay and highest grade held]; 33 U.S.C.A. § 853o(a) (West 1986 and Supp. 1991) [NOAA retired pay is calculated in accordance with basic pay and highest grade held].[17] If the discriminatory classification created by Kan.Stat.Ann. § 79-32,117(c) truly intended to account for actual or perceived differences in the nature of retirement income, however, these federal civilian retirees would not be taxed. *See Davis*, 489 U.S. at 817.

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17 Officers or employees of the PHS and NOAA participate in retirement systems which are similar in nature to the military retirement system. *See* STAFF OF HOUSE COMM. ON ARMED SERVICES, 100TH CONG. 1ST SESS., *Report on Title 37, United States Code: Pay and Allowances of the Uniformed Services (As Amended Through April 3, 1987) and Related Material 160* (Comm. Print 1987). However, PHS retirees have not been subject to involuntary recall to active duty for almost 40 years. *Cf.* 42 U.S.C.A. § 212(c) and § 217 (West 1991) [authorizing involuntary recall only when the President has declared the PHS as a military service in time of war or national emergency] *with* Exec. Order No. 10,367, 17 Fed. Reg. 5929 (1952) [returning the PHS to its status as a non-military uniformed service]. No comparable statute appears to expessly authorize involuntary recall of NOAA retirees to active duty. *See* 33 U.S.C.A. § 851, *et seq.* (West 1986 and Supp. 1991). Therefore, it cannot be reaslitically suggested that PHS or NOA retired pay is granted in consideration of their availability for recall to active federal service.

Likewise, if the Kansas classification scheme truly intended to treat government retirees who may be recalled to active service differently from those who are not, KITA would do so. But it does not. For example, retirement benefits paid by the United States from the Civil Service Retirement and Disability Fund to retired United States Magistrates are exempt from KITA taxation, *see* Kan.Stat.Ann. § 79-32,117(c)(vii) (Supp. 1990), even though such retirees may be recalled to active judicial service. *See* 28 U.S.C.A. § 636(h) (West Supp. 1991).[18] Furthermore, although retired judges and justices of Kansas are only "relieved of further *active duties* on the court," *see* Kan.Stat.Ann. § 20-2614 (1988) [emphasis added], and "may be designated and assigned to perform such judicial service and duties as such retired justice or judge is willing to undertake," Kan.Stat.Ann. § 20-2616 (1988), their retirement benefits are exempt from KITA taxation. *See* Kan.Stat.Ann. § 20-2618 (1988); Kan.Stat.Ann. § 79-32,117(c)(vii) (Supp. 1990). Conversely, retirement benefits paid by the United States to all retired members of the NOAA and CIA, and to certain retired members of the PHS, Foreign Service and federal judiciary are fully taxed under KITA even though such federal retirees may not be involuntarily recalled to active service. *See, e.g.*, Pub. L. 88-643, Title II, § 271(a), *reprinted in* 50 U.S.C.A. § 403 note (West 1991) [CIA retirees may be recalled to active service only "with the consent of the retired participant"]; 42 U.S.C.A. §§ 212(c) and (g)(3) (West 1991) [PHS retirees

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18 In relevant part, 28 U.S.C.A. 636(h) (West Supp. 1991), provides:

> A United States magistrate who has retired may, upon the consent of the chief judge of the district involved, be recalled to serve as a magistrate in any judicial district council of the circuit within which such district is located. Upon recall, a magistrate may receive a salary for such service in accordance with regulations promulgated by the Judicial Conference, subject to the restrictions on the payment of an annuity set forth in section 377 of this title or in subchapter III of chapter 83, and chapter 84, of title 5 which are applicable to such magistrate. . . .

involuntarily separated after being passed over twice for promotion to a senior grade may never be recalled to active service].[19]

If KITA truly intended to account for differences between contributory and non-contributory public sector retirement systems, as suggested by the Kansas Supreme Court, it would do so. But it does not. For example, retirees of the Kansas board of regents and educational institutions under its management who have made no statutory retirement contributions in accordance with Kan.Stat.Ann. § 74-4925(1)(a) and (4) or § 74-4925b (Supp. 1990) receive retirement benefits that are completely exempt from KITA taxation. *See* Kan.Stat.Ann. § 74-4923(b) (Supp. 1990).[20] Conversely, the retirement systems for members of the CIA and Foreign Service, as well as bankruptcy judges and United States Magistrates covered by 28 U.S.C.A. § 377, are all contributory; yet these classes of federal retirees are fully subject to KITA taxation. *See* Pub. L. 88-643, Title II, § 202 and § 211, *reprinted in* 50 U.S.C.A. § 403 note (West 1991) [CIA]; 22 U.S.C.A. § 4045(a) and § 4071e(a) (West 1990 and Supp. 1991) [Foreign Service]; 28 U.S.C.A. § 377(j) (West 1968 and Supp. 1991) [bankruptcy judges and magistrates]; Kan.Stat.Ann. § 79-32,117(c) [no exemption for these federal retirees].[21]

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19 There is no apparent statutory authorization to involuntarily recall NOAA retirees, retired non-career members of the Foreign Service, retired claims court judges and wholly retired Article III judges and justices.

20 These retirees fund their tax-sheltered annuities through salary reductions rather than out-of-pocket contributions. *See* Kan.Stat.Ann. § 74-4925(4); Kan.Stat.Ann. § 74-4925b. But since salary reductions are not income, these State retirees receive a "double deduction" under KITA by avoiding taxation at the time of each salary reduction and at the time retirement benefits are received.

21 The same can be said about restrictions on retirement activities and double-dipping, age and years of service at retirement, and amounts of retirement income. For example, state and local retirees are subject to our state and federal criminal codes, and may be subject to court-martial jurisdiction under certain circumstances, 10 U.S.C.A. § 802(a)(10) (West 1983), but their retirement pay

The absence of such distinctions is further highlighted by the Kansas tax treatment of federal military retirees who also retire from federal civil service. Every such military retiree is given the option to, in effect, convert his or her military retired pay into a federal civil service retirement annuity under applicable provisions of 5 C.F.R. § 831.301 (1991).[22] Although such military retirees retain their military "status" and remain subject to recall to active duty under 10 U.S.C.A. § 688(a) (West Supp. 1991), § 672(a) (West 1983), or § 675 (West Supp. 1991), their retirement pay is completely exempt from Kansas income taxation for the sole reason that it is received "under the federal civil service retirement system, from the civil service retirement and disability fund." *See* Kan.Stat.Ann. § 79-32,117(c)(vii). This phenomenon clearly underscores that differential taxation of federal military retirement

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is exempt from KITA taxation. State and federal civil service retirees are also subject to conflict-of-interest restrictions prescribed by law, *see, e.g.*, 18 U.S.C. § 207 (1990); 5 C.F.R. § 737 (1991); Kan.Stat.Ann. § 46-233 and § 46-241 (Supp. 1991), but their retirement pay is exempt from Kansas income taxation. Likewise, virtually all classes of retired federal, state and local retirees whose retirement pay is exempt from KITA taxation are subject to restrictions against double-dipping. *See, e.g.*, 5 U.S.C.A. § 8344(a) (West 1980 and Supp. 1991); Kan.Stat.Ann. § 74-4914(6) (Supp. 1991), § 74-4957(5), and § 74-4957a(4) (Supp. 1991); and Kan.Stat.Ann. § 13-14a08. Under the Hiss Act, federal civil servants may forfeit their entitlement to retirement benefits upon conviction of certain criminal offenses, 5 U.S.C.A. §§ 8311 to 8315 (West 1980), but their retirement pay is exempt from Kansas income taxation. All firefighters and law enforcement officers who retire with full benefits at age 50 under 5 U.S.C.A. § 8336(c)(1) (West 1980 and Supp. 1991), Kan.Stat.Ann. § 74-4957(3) or Kan.Stat.Ann. § 13-14a08 receive retirement pay that is tax exempt under KITA, while members of the Armed Forces who retire at the same age receive retirement pay that is fully taxed under KITA. Discriminatory taxation under KITA is clearly not "directly related" to or based upon any of these purported differences between classes of public sector retirees.

22 "An employee or member applying for [a federal civil service] annuity who otherwise meets all conditions for receiving credit for military service, but who is in receipt of retired or retainer pay which bars credit for military service may elect to waive the retired or retainer pay and have the military service added to civilian service for annuity computation purposes." 5 C.F.R. § 831.301(c) (1991).

benefits in Kansas is not directly related to continuing military status in retirement; instead, "source" of compensation is the exclusive basis for discrimination.

The foregoing discussion demonstrates that, like the discriminatory tax scheme struck down in *Davis,* differential taxation in Kansas is not directly related to any significant differences in the nature or funding of retirement benefits, or continuing burdens associated with retirement. Instead, "source" of compensation is the operative key to differential treatment, and no other factor plays any role in the taxation or exemption calculus. *Compare* Kan.Stat.Ann. § 79-32,117(c) (Supp. 1990) *with Davis,* 489 U.S. at 806 and n.2 [quoting Mich. Comp. Laws Ann. § 206.30(1)(f) (Supp. 1988)]. Even if one assumes the propriety of comparing all federal, state and local government retirees who are exempt from taxation with a select subset of federal retirees who are not, neither Congress nor the Kansas Legislature considers military retired pay as current compensation for purposes of taxation. Moreover, no Kansas statutory authority or legislative history establishes any consistent reason for discrimination against federal military retirees except the "source" of their retired pay.

To the contrary, Kan.Stat.Ann. § 79-32,117(a) (Supp. 1990) treats military retired pay, and includes it in the Kansas income tax base, as pension income rather than as wages, salaries or compensation for current service. Since this statute utilizes federal adjusted gross income as "the starting point" to determine "an individual's Kansas income tax liability," Pet. App at 7a, it is significant that military retired pay is taxable under 26 U.S.C. § 61(a)(11) (1988) as ordinary *pension income* when received. *See McCarty,* 453 U.S. at 214 n.7 [citing 26 U.S.C. § 61(a)(11), and 26 C.F.R. § 1.61-11 (1980)]. *See also Strickland v. Commissioner,* 540 F.2d 1196, 1198 (4th Cir. 1976) [gross income includes nondisability military "retirement pay" when received

under § 61(a); citing 26 C.F.R. § 1.61-2(a)(1) and § 1.61-11(a)].[23] Because Kan.Stat.Ann. § 79-32,117(a) incorporates this federal treatment precisely, the Kansas statute also taxes military retired pay as ordinary pension income under 26 U.S.C. § 61(a)(11), rather than as wages, salaries or other compensation for current services.[24] While the Kansas Supreme Court acknowledged that "[f]ederal AGI includes military retirement benefits and state and local retirement benefits, 26 U.S.C. § 61(a) (1988)," Pet. App. at 7a-8a, the opinion below ignored the fact that all of these retirement benefits are includible in federal adjusted gross income -- "from whatever source derived" -- as retirement compensation. *See* 26 U.S.C. §61(a)(9) (1988) [annuities]; § 61(a)(11) (1988) [pensions]. However, since the specific statutory basis for taxing military retired pay as pension

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[23] TREAS. REG. § 1.61-11, 26 C.F.R. § 1.61-11 (1991), provides in relevant part:

> (a) *In general.* Pensions and retirement allocations paid . . . by the Government . . . constitutes gross income unless excluded by law. Usually, where the taxpayer did not contribute to the cost of a pension and was not taxable on his employer's contributions, the full amount of the pension is to be included in his gross income * * * * when amounts are received from other types of pensions, a portion of the payment may be excluded from gross income.

While "pay of persons in the military or naval forces of the United States, retired pay of employees, pensions, and retirement allowances are income to the recipients unless excluded by law," TREAS. REG. § 1.61-2(a), 26 C.F.R. § 1.61-2(a) (1991), this regulation draws express contextual distinctions between these forms of income and "wages" or "salaries" – the traditional benchmarks of current compensation for current service – for income tax purposes.

Other courts have also concluded that military retired pay is taxable as ordinary pension income under Internal Revenue Code § 61(a)(11). *See, e.g., In re Marriage of Schissel*, 292 N.W.2d 421, 427 (Iowa 1980); *Cose v. Cose*, 592 P.2d 1230, 1231 (Alaska 1979).

[24] Federal adjusted gross income consists of gross income, as defined by 26 U.S.C. § 61(a), minus specified deductions. 26 U.S.C. § 62 (1988).

income accordingly rejects its tax treatment as compensation for current services, this latter view of military retired pay does not -- and cannot -- serve as a bona fide reason or justification for tax discrimination.

In addition to the treatment of military retired pay as "pensions" under 26 U.S.C. § 61(a)(11), other provisions of federal and state law relevant to taxation consistently treat military retired pay in the same manner as pension income. For example, the Federal Insurance Contributions Act ["FICA"] levies a tax on "wages" for employment, but it does not tax military retired pay or any other form of pension income. *See* 26 U.S.C.A. §§ 3121(a)(5), (i)(2), (m) and (v)(3) (West Supp. 1991). Similarly, although wages for employment are generally subject to involuntary income tax withholding, state income taxes may not be withheld from military retired pay unless the taxpayer "voluntarily requests such withholding in writing." *See* 10 U.S.C.A. § 1045(a) (West Supp. 1991). Under the Internal Revenue Code, military retirees who fund survivor annuities through reductions in retired pay are also extended the same tax treatment as civil service retirees and other retirees under qualified pension plans. *See* 26 U.S.C. § 122(a) (1988) [gross income does not include such reductions in retired pay]; H.R. Rep. No. 1118, 89th Cong., 1st Sess. 4-5 (1965). Likewise, contributions to an Individual Retirement Account ["IRA"] made with military retired pay do not qualify for an IRA deduction because it is treated as pension income. *See* 26 U.S.C. § 219(f)(1) (Supp. 1989); Weinstein, 6 *Mertens Law of Federal Income Taxation* § 25C.12 at 58 (1988); Pet. App. at 24a-25a. Therefore, it is implausible to suggest that discriminatory treatment under KITA is directly related to any material differences in the nature of military retired pay or that Congress has consented to such differential taxation.

The otherwise consistent tax treatment of military retired pay in the same manner as annuities, pensions and deferred compensation plainly demonstrates that Congress and the Kansas Legislature do not perceive any significant differences in the character or funding of such benefits that would furnish a bona

fide reason or justification for differential taxation of military retirees. Nevertheless, while federal income tax law treats all forms of nondisability retirement income in the same manner regardless of its source, the "source" alone expressly determines whether it is taxable or exempt from taxation under Kan.Stat.Ann. § 79-32,117 (Supp. 1990). As in *Davis*, the Kansas Legislature's intended basis for differential tax treatment, therefore, is revealed by a classification which discriminates against all retired officers or employees of the United States who receive benefits -- regardless of their nature for other purposes or method of funding -- from a federal source which KITA does not recognize as the basis for an exemption. See Kan.Stat.Ann. § 79-32,117(c) (Supp. 1990).

In other relevant and related contexts, the Kansas Legislature also plainly recognizes and treats military retired pay as pension income or deferred compensation rather than current compensation. For example, federal military retirees are not authorized to purchase participating service credit under the Kansas Public Employees Retirement System for any period of "active service" in the Armed Forces which is "the basis for *military pension rights*." Kan.Stat.Ann. § 74-4919h(1) (Supp. 1990) [emphasis added]. *See also* Kan.Admin.Regs. § 80-3-16 (1989) [characterizing military retired pay as "a military longevity pension" in KPERS implementing regulations]. This prohibition was enacted by the Kansas Legislature in 1974 to "preclude the doubling up of benefits under KPERS and the military pension system," *REPORT OF SPECIAL COMMITTEES TO THE 1974 LEGISLATURE, RE: PROPOSAL NO. 22 -- RETIREMENT MATTERS*, 22-13 (1974), and it vividly highlights the legislative belief in Kansas that "military pension rights" are actually based on past military service instead of current service.

Like other forms of pension income or deferred compensation, military retired pay is also divisible as "marital property" in actions for divorce, separate maintenance or annulment in Kansas because the legislature has expressly determined that "[a]ll property owned by married persons"

specifically includes "the present value of any vested or unvested military retirement pay." Kan.Stat.Ann. § 23-201(b) (1988). This treatment of military retirement pay is significant for two compelling and undisputed reasons. First, the "*intent and purpose of the legislature* in adopting subsection (b)" of Kan.Stat.Ann. § 23-201 "*was clearly limited to affecting taxation*" by making the transfer of marital property "a nontaxable event" between co-owners. *Wachholz v. Wachholz*, 4 Kan.App.2d 161, 163-64, 603 P.2d 647 (1979) [legislative history citations omitted and emphasis added].[25]

Second, the legislative characterization and treatment of military retired pay as "property" which becomes "marital property" in proceedings to dissolve marriage rests upon a premise -- that military retired pay is deferred compensation for services performed during past years of marriage -- which repudiates any alleged basis for its consideration as "current compensation." *Cf. McCarty*, 453 U.S. at 221 ["The community property division of military retired pay rests on the premise that that pay, like a typical pension, represents deferred compensation for services performed during the marriage."]. At the philosophical core, these characterizations of military retired pay are diametrically opposed and mutually exclusive. Since military retired pay is generally treated the same as other forms of pension income and deferred compensation for purposes of federal and state income taxation, and domestic property determinations with actual or potential income tax consequences, it is simply inconceivable that discrimination against federal military retirees is based on any unique character of their retirement compensation.

The opinion below acknowledges that the Uniformed

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[25] The opinion of the Kansas Court of Appeals in *Wachholz* has been expressly approved by the Kansas Supreme Court. *See Redmond v. Redmond*, 229 Kan. 565, 629 P.2d 142 (1981). *Cf. Cady v. Cady*, 224 Kan. 339, 581 P.2d 358 (1978) [filing a petition for divorce or separate maintenance creates a species of co-ownership in property acquired before and during marriage which avoids a taxable transfer of such property upon divorce or separation].

Services Former Spouses' Protection Act, Pub. L. No. 97-252, 96 Stat. 730 (1982) ["USFSPA"], authorizes the states to treat the disposable portion of military retired pay as "marital property" and that the Kansas Legislature amended Kan.Stat.Ann. § 23-201(b) in 1987 to do so. Pet. App. at 19a-20a. Since the amendment merely inserted the phrase "including the present value of any vested or unvested military retirement pay," 1987 Kan. Sess. Laws, ch. 120, § 1, this permissible action simply reiterated the settled legislative belief that such pay is a "military pension" or "military longevity pension" based on past years of creditable service. *See* Kan.Stat.Ann. § 74-4919h (Supp. 1990); Kan.Admin.Regs. § 80-3-16 (1989). While Kansas has never previously recognized or endorsed, by statute or legislative history, any view of military retired pay as current compensation earned during retirement, this state policy decision clearly rejected any supposed basis for characterizing or treating military retired pay as anything other than pension income or deferred compensation under state law.

However, in principal reliance upon *Cornetta v. United States*, 851 F.2d 1372, 1382 n.3 (Fed.Cir. 1987), and *United States v. Tafoya*, 803 F.2d 140, 142 n.7 (5th Cir. 1986), the Kansas Supreme Court concluded that "the USFSPA did not change the legal characterization of military retirement pay for any other purpose than cases involving marital property settlements." Pet. App. at 21a and 21a-23a.[26] This view, however, offers no meaningful insight into -- and, in fact, ignores -- whether Kansas "truly intended" to discriminate against federal military retirees on any basis other than the "source" of their pay or compensation.

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[26] In reality, the USFSPA did not change the so-called "legal characterization of military retirement pay" for any purpose. Instead, the Act simply empowers state courts to apply principles of state law in the treatment of disposable military retired pay in actions to dissolve marriage. *See* 10 U.S.C.A. § 1408(c)(1) (West Supp. 1991) ["a court may treat retired pay payable to a member * * * either as property solely of the member or as property of the member and his spouse in accordance with the law of the jurisdiction of such court."].

Nevertheless, the nature of the statutory classification, federal and state statutes relevant to the treatment of military retired pay for purposes of income taxation and domestic property divisions, and the Kansas Legislature's express determination that qualifying years of service in the Armed Forces gives rise to "military pension rights" for purposes of the State retirement system all demonstrate that the inconsistent tax treatment in Kansas is not "directly related to" any "'significant differences'" between the two classes of affected government retirees. *See Davis*, 489 U.S. at 816-817 [citations omitted]; *see also Phillips Chemical Co.*, 361 U.S. at 383-385. Moreover, the unsupported suggestion that existing federal case law involving nontax matters prohibits the Kansas Legislature from characterizing or treating military retired pay *for tax purposes* in the same manner as other federal, state and local government retirement benefits directly conflicts with the mandate of equal tax treatment for retired federal officers and employees set forth in 4 U.S.C. § 111 (1988) and does not give rise to any issue of federal preemption.[27]

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[27] Respondents' suggestion that states are required to characterize and treat military retired pay as "current compensation" for state income tax purposes, Respondents' Brief in Opposition at 7, is entirely without merit. In *McCarty*, this Court expressly refused to decide "whether federal law prohibits a State from characterizing retired pay as deferred compensaton" for any purpose. 453 U.S. at 223. Instead, the *McCarty* decision invoked principles of federal preemption to conclude that "the application of community property law conflicts with the military retirement scheme regardless of whether retired pay is defined as current or as deferred compensation." *Id.* Moreover, the Court specifically relied upon the status of military retired pay as a "personal entitlement" and the grave harm to clear and substantial federal interests in preempting the application of community property law. *McCarty*, 453 U.S. at 224-228 and 232-235. *See also Mansell*, 490 U.S. at 584 [construing the holding and reasoning of *McCarty*]. Therefore, the further undecided suggestion in *McCarty* that military retired pay might be properly viewed as "reduced compensation for reduced current services" in the context of community property divisions, 433 U.S. at 221-222, is pure dicta which has no direct or indirect application to state income taxation of military retired pay.

To the contrary, this Court also specifically recognized in *McCarty* that for purposes of federal income taxation, military retired pay is treated in the same

Under the circumstances, reversal of the judgment below is necessary to enforce the unequivocal mandates of 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity.

D. Differential Taxation of Federal Military Retirees Is Not "Justified By" Any Significant Differences Between the Classes of Favored and Disfavored Government Retirees.

The Kansas Supreme Court held that "[a] state is justified in taxing reduced current compensation paid for reduced current services while not taxing deferred compensation." Pet. App. at 30a. Without explanation, the opinion below simply accepts the "rationale of the federal cases" to support this conclusion, even though none of these decisions involve 4 U.S.C. § 111, intergovernmental tax immunity or discrimination against military retirees. Moreover, the court makes no effort to demonstrate that the treatment of military retired pay as compensation for current service has been endorsed by Congress or the Kansas Legislature for purposes of taxation; that such treatment deals with a proper domestic concern of the State; or that it is directly related to a *legitimate* state interest.

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manner as other forms of non-contributory pension income. 453 U.S. at 214 n.7 [construing 26 U.S.C. § 61(a)(1) and 26 C.F.R. § 1.16-11 (1980)]. In addition, the holding in *McCarty* was promptly overturned by specific legislation to enable the states to treat disposable military retired pay the same as other retirement benefits in actions for marital dissolution. *See Mansell*, 490 U.S. at 584-585 and 594-595; *Id.* at 596-597 [O'Connor J., dissenting]. Since the transfer of property upon divorce may have federal and state income tax consequences depending upon whether the property is jointly or separately owned, *see, e.g., United States v. Davis*, 370 U.S. 65 (1962), enactment of the Former Spouses Protection Act supports an inference that Congress intended the treatment of military retired pay in divorce proceedings to have the same tax consequences afforded pensions and other retirement benefits. Thus, it is implausible that Congress has consented or would consent to discriminatory state taxation of military retired pay in the absence of clear statutory authority or legislative history which establishes otherwise. *See also* 4 U.S.C. § 111; *supra* at 14-15 n.12.

Indeed, Congress does not recognize or endorse any distinctions between federal officers or employees who are entitled to protection from discriminatory state taxation. *See* 4 U.S.C. § 111.[28] In view of the equal treatment objectives of the Public Salary Tax Act of 1939, *see supra* at 14-15 n.12, it is significant that all forms of federal, state and local government retirement benefits, including military retired pay, are subject to substantially the same treatment and burdens of income taxation under the Internal Revenue Code regardless of any actual or perceived differences in their character or method of funding. Given these circumstances, the Kansas Supreme Court's stated reliance upon differences in the nature or funding of compensation to justify tax discrimination conflicts with the intent of Congress that military retirees receive the same tax treatment as all other federal, state and local government retirees. To paraphrase *Davis*:

> It is difficult to imagine that Congress consented to discriminatory taxation of the pensions of retired [members of the Armed Forces] while refusing to permit such taxation of [its retired civil service] employees, and nothing in the statutory language or even in the legislative history [behind 4 U.S.C. § 111] suggests this result.

489 U.S. at 810. To the contrary, when Congress amended the Internal Revenue Code to provide military retirees with the same tax treatment afforded civil service retirees and other retirees under qualified pension plans with respect to income, estate and gift taxation of survivor annuities, *see* Pub. L. 89-365, 80 Stat. 32

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[28] Since the plain language of Section 111 does not draw any distinctions between federal civilian and military retirees, several courts have concluded that *all* retired officers and employees of the United States are entitled to the same tax treatment as state and local government retirees. *See, e.g., Hackman v. Director of Revenue*, 771 S.W.2d 77, 79-80 (Mo. 1989) (*en banc*), *cert. denied*, 493 U.S. 1019 (1990); *Bohn v. Waddell*, 164 Ariz. 74, 790 P.2d 772, 780 (1990), *aff'd on reconsideration*, 807 P.2d 1 (T.C. 1991), *appeal pending*, No. 1 CA-TX 90-029 (Ariz. App. 1991).

(1966), it clearly endorsed the supporting legislative history, which states:

> Your committee believes that members (or former members) of the Uniformed Services should be treated essentially the same as retirees under the civil service program and other qualified pension or annuity plans. Your committee has concluded that *there is no substantial grounds for distinguishing the tax treatment of the plan for the uniformed services from these other plans* * * * * As a result, your committee has concluded that these uniformed services retirees should be treated in the same manner as pensioners under qualified plans.

H.R. Rep. No. 1118, 89th Cong. 1st Sess. 4-5 (1965) [emphasis added]. Therefore, regardless of whether military retired pay may be properly viewed as current compensation for other distinct purposes, it is not significantly different for tax purposes to justify discriminatory state income taxation.

Although the Kansas Supreme Court focused its attention almost exclusively upon alleged differences between the military and civilian retirement systems in its effort to uphold the State tax scheme, it erred in ignoring similarities vital to proper application of statutory and constitutional principles of intergovernmental tax immunity. For example, since entitlement to military retired pay is generally predicated upon at least 20 years of service, *Mansell*, 490 U.S. at 583, and the amount of retired pay "is calculated on the basis of the number of years served and rank achieved," *McCarty*, 453 U.S. at 214, like other forms of government retirement income, it possesses significant features of deferred compensation for purposes of the tax immunity doctrine. *Cf. Davis*, 489 U.S. at 808. In *McCarty*, after observing the truth that military retired pay "bears some of the features of deferred compensation," the Court significantly acknowledged:

> The amount of retired pay a service member receives is calculated not on the basis of continuing duties he actually performs, but on the basis of years served on active duty and the rank obtained prior to retirement. . . . Furthermore, should the service member actually be recalled to duty, he receives additional compensation according to the active duty pay scale, and his rate of retired pay is also increased thereafter.

453 U.S. at 223 n. 16 [citations omitted].

Because military retired pay is not based on any affirmative duties actually performed in retirement, it is hardly comparable for tax purposes to "wages" or "salaries" earned by any officers or employees performing active government service. Indeed, upon retirement, members of the Armed Forces: lose their entitlement to active duty pay and allowances, 37 U.S.C. § 204(a), § 402(a), § 403(a) (1988); acquire the status of a "retired" officer or employee; and become entitled to "retired pay" in accordance with governing federal statutes, *see McCarty*, 453 U.S. at 214. While military retirees may receive cost-of-living increases in retirement, *see* 10 U.S.C.A. § 1401a(b) (West Supp. 1991), retired pay may not generally be "recomputed to reflect any increase in the rates of basic pay for members of the armed forces." *Id.* at § 1401a(a).[29] Relying upon some of these

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[29] In *United States v. Tyler*, 105 U.S. 244 (1881), this Court held that a retired Army Captain was entitled to a statutory pay increase "for every period of five years' service" because he was "by law a part of the army;" he could be "assigned by [his] superior officers to specified duties by detail as other officers are;" and he could be tried and dismissed from the service by court-martial for breaches of the rules and articles of war. *Id.* at 244-246. The narrow question presented for decision was simply whether Captain Tyler was deemed to be "in the military service" for purpose of a pay increase awarded every five years to all persons in the service. *Id.* at 244.

At the time of *Tyler*, it appears that retired officers could be assigned by superior officers "to specified duties by detail" in the same manner as officers

factors to invalidate the Colorado tax scheme in effect before *Davis*, the Supreme Court of Colorado persuasively and unanimously concluded:

> [T]he overall scheme of the [military] retirement benefits is akin to a civilian pension earned by the service member for years of active service. For example, in the army, members are not allowed to draw retirement pay unless they have served a specified period of active service, normally twenty years. 10 U.S.C. § 3911 (1988). Retirement terminates the right to active duty pay and allowances. 37 U.S.C. § 204(a) (1988). In addition, the amount of retirement pay is directly

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serving on active duty and that officers required to perform "less than full service" following retirement would receive no additional compensation for actual duties assigned. 104 U.S. at 246. In the contemporary Armed Forces, however, it does not appear that military retirees may be assigned to duties by detail or otherwise unless they are first recalled to active duty by the Secretary of their service. Moreover, in the event of recall, military retirees are now paid in accordance with the active duty pay scale and, upon returning to retired status, the amount of their retired pay may be increased based on such additional period of active service. Therefore, contemporary retired pay is much more comparable to pension income than it was more than 110 years ago.

In addition, the statutory basis for Captain Tyler's pay increase, then uniformly applicable to officers on active duty and those who retired from active service only, was legislatively abandoned in 1958. *See* STAFF OF HOUSE COMM. ON ARMED SERVICES, 100th Cong., 1st Sess. *Report on Title 37, United States Code: Pay and Allowances of the Uniformed Services (As Amended Through April 3, 1987) and Related Material* 162-163 (Comm. Print 1987) [Pub. L. 85-422 terminated the practice of increasing retired pay according to increase in the active duty pay scale after a one-time adjustment of 6 percent to the retired pay of all personnel on June 1, 1958]. Since 1980, increases in military retired pay have been determined using the same method, effective date and payment schedule used for federal civil service retirement pay increases. *Id.* Since military retired pay increases parallel the increases in civil service annuities as a result of specific congressional action, this furnishes additional evidence that these forms of retirement compensation are viewed by Congress as substiantially comparable.

> proportional to the number of years spent on active duty. 10 U.S.C. §§ 3926, 3991, 6325-6327, 8929 (1988).

Kuhn v. State of Colorado, 817 P.2d 101, 108 (Colo. 1991) (en banc).

In view of the substantial similarities between the military retirement system and other government retirement systems, it is not surprising that Congress and the Kansas Legislature have generally regarded military retired pay as comparable to other forms of retirement income for purposes of income taxation and marital property determinations in state divorce proceedings which may have tax consequences. It is also not surprising that the Kansas Public Employees Retirement System considers military retired pay as a "military pension," Kan.Stat.Ann. § 74-4919h(1) (Supp. 1990), or a "military longevity pension," Kan.Admin.Regs. § 80-3-16 (1989), in prohibiting military retirees from purchasing additional service credit under the State retirement system. *Id.* It is, therefore, inconceivable that tax discrimination against military retirees in Kansas is justified by any significant differences between the classes of retired government employees affected by the State's differential tax scheme.

Despite these fundamental similarities with other forms of government retirement income, and the absence of any relevant differences recognized by statute or otherwise, Kansas discriminates against both military and civilian retirement benefits because they are derived from a federal source which is not specifically exempt from state income taxation under Kan.Stat.Ann. § 79-32,117(c) (Supp. 1990).

The Kansas Supreme Court's discussion of intergovernmental tax immunity is also notably silent with respect to any legitimate state interest or proper domestic concern which is promoted by its alleged justification for discrimination. Nevertheless, the discriminatory exemption scheme exists as part and parcel of the State's retirement system, the primary purpose

of which is to allow employees to retire "from *active service* without prejudice" or hardship, to provide for "old age, death and termination of employment," and to effect "economy and efficiency in the administration of government affairs." Kan.Stat.Ann. § 74-4901 (1985) [emphasis added]. *Cf.* Pet. App. at 34a-35a [discussing these purposes only in conjunction with a state constitutional issue evaluated under the rational basis test]. By offering tax-exempt retirement benefits, Kansas plainly seeks to advance its interest "in hiring and retaining qualified employees," Pet. App. at 35a, and in protecting its employees from economic hardship upon retirement, while minimizing its employment costs.

Recognizing the impermissible and offensive nature of promoting rational state interests through discrimination against the United States and its officers or employees, this Court cogently observed in *Davis*:

> In order to provide the same after-tax benefits to all retired state employees by means of increased salaries or benefit payments instead of a tax exemption, the State would have to increase its outlays by more than the cost of the current tax exemption, since the increased payments to retirees would result in higher federal income tax payments in some circumstances. *This fact serves to illustrate the impact on the Federal Government of the State's discriminatory tax exemption for state retirees. Taxes enacted to reduce the State's employment costs at the expense of the federal treasury are the type of discriminatory legislation that the doctrine of intergovernmental tax immunity is intended to bar.*

489 U.S. at 815 n.4. [emphasis added]. Like the Michigan statute struck down in *Davis*, the Kansas source-related classification violates 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity by unjustifiably reducing the State's employment costs at the expense of the United States and its retirees who are subject

to differential taxation.

The unjustified discrimination against military retirees by the Kansas tax scheme is especially egregious because it carries the potential to frustrate the objectives of Congress in establishing a military retirement system. Pursuant to express grants of constitutional authority "Congress has enacted a military retirement system designed to accomplish two major goals: to provide for the retired service member, and to meet the personnel management needs of the active military forces." *McCarty*, 453 U.S. at 232-233. Whatever differences which may exist between the military retirement system and other retirement systems are the result of considered determinations made by Congress in furtherance of our national interests [*see* U.S. Const. art. I, § 8, cls. 12, 13, 14 and 18] and do not involve proper domestic concerns of any State in the Union. If the States are permitted to discriminate against military retirees in matters of income taxation, the value of a military career may be viewed as less attractive than careers in other forms of government or private service and the active service needs of the Armed Forces could suffer through the loss of valuable manpower. Likewise, the comparative reduction in retired pay from discriminatory taxation might not only discourage retirement, but also give some service members a positive incentive to remain on active duty. *Cf. McCarty*, 453 U.S. at 235 ["Congress has determined that a youthful military is essential to the national defense; it is not for States to interfere with this goal by lessening the incentive to retire created by the military retirement system"]. Therefore, since Congress has not consented to discriminatory taxation of military retired pay, the differential tax system in Kansas treads upon the prerogatives of the Federal Government and poses a potential threat to the attainment of its national objectives recognized in *McCarty*, 453 U.S. at 232-235.

Under the circumstances, differential taxation of military retired pay is not justified by any significant or permissible differences between federal military retirees and other government retirees. Therefore, the Kansas Income Tax Act violates 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental

immunity, as reiterated and applied in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989), by favoring retired officers and employees of the State and its political subdivisions over retired officers and employees of the United States Armed Forces.

CONCLUSION

The judgment of the Supreme Court of the State of Kansas should be reversed and this case should be remanded for further proceedings so that the Petitioners, and members of the designated class of affected federal retirees, can secure appropriate relief from unconstitutional Kansas income taxation.

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No. 91-611

In The

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October Term, 1991

KEYTON E. BARKER and PAULINE BARKER, et al.,

Petitioners,

vs.

STATE OF KANSAS; KANSAS DEPARTMENT OF REVENUE; SECRETARY OF REVENUE OF THE STATE OF KANSAS; and DIRECTOR OF TAXATION OF THE STATE OF KANSAS,

Respondents.

On Writ of Certiorari to the Supreme Court of the State of Kansas

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QUESTION PRESENTED

Whether a State violates 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity by taxing federal nondisability military retired pay while exempting from taxation retirement benefits paid by the State and its political subdivisions.

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No. 91-611

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October Term, 1991

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STATE OF KANSAS; KANSAS DEPARTMENT OF REVENUE; SECRETARY OF REVENUE OF THE STATE OF KANSAS; and DIRECTOR OF TAXATION OF THE STATE OF KANSAS,

Respondents.

On Writ of Certiorari to the Supreme Court of the State of Kansas

BRIEF FOR RESPONDENTS

STATUTORY PROVISIONS INVOLVED

1. The relevant text of 4 U.S.C. § 111 is set forth in the Petition at 2-3.

2. The relevant text of Kan. Stat. Ann. § 79-32,117 (Supp. 1990) is set forth in the Appendix to the Petition at 47a-48a.

STATEMENT OF THE CASE

Parties and allegations

This action was commenced on April 17, 1989, by the filing of two separate petitions; one in the District Court

of Leavenworth County, Kansas (*Lober*, J.A. 9-13), and the other in the District Court of Shawnee County, Kansas (*Barker*, J.A. 3-9). These petitions were filed on the last day in which to claim a Kansas income tax refund for the 1984 tax year under the four-year statute of limitations then in effect. *Lober* was later transferred to the District Court of Shawnee County where it was consolidated with *Barker*. (J.A. 33-34).

Petitioners are retired members of the United States Armed Forces residing in Kansas.[1] After consolidation these proceedings were certified by the trial court as a class action pursuant to Kan. Stat. Ann. § 60-223(b)(1) and (b)(2) (1983). (J.A. 55). The class was designated as:

> All retired members of the federal or United States armed forces who are recipients of federal armed forces retirement benefits [under applicable provisions of Title 10 and Title 14 or (*sic*) the United States Code] subject to Kansas state income taxation during one or

---

[1] The class of taxpayers represented by petitioners consists exclusively of retired members of the United States Armed Forces. The petitioners' brief devotes considerable attention to the taxation of retirement benefits received by retirees of federal agencies such as the Public Health Service, the National Oceanic and Atmospheric Administration, the Central Intelligence Agency, the Foreign Service and the federal judiciary. (Pet. Br. 20-27). However, these retirees are not parties to this action and the taxation of their retirement benefits is not at issue.

As indicated in the affidavits filed by the representatives of the plaintiff class, all class members receive nondisability military retired pay which is taxable pursuant to the provisions of the Kansas Income Tax Act. (R. at 1053-1201). However, Kansas does not tax all military retirement benefits. Military disability retired pay and Veterans Administration pensions are exempt from Kansas income tax. 38 U.S.C. § 5301(a), 26 U.S.C. § 104(a), Kan. Stat. Ann. 79-32,117 (Supp. 1990). It is only the taxation of nondisability military retired pay that is at issue in this case.

> more of the tax years from 1984 through 1989 and, where applicable, their respective spouses who have filed or will file joint Kansas state income tax returns during one or more of the tax years from 1984 through 1989; (J.A. 56).

There are approximately 14,100 class members. (J.A. 53). Respondents are the State of Kansas, the Kansas Department of Revenue, the Secretary of Revenue of the State of Kansas and the Director of Taxation of the State of Kansas. The current Secretary of Revenue is Mark V. Beshears and the current Director of Taxation is Alisa M. Dotson. Neither Beshears nor Dotson held office at the time this action was commenced.

The Kansas Income Tax Act, Kan. Stat. Ann. § 79-3201 *et seq.* (1989) ("KITA"), provides that military retired pay is taxable while retirement benefits paid by the State and its political subdivisions are exempt from taxation. Petitioners allege this practice is discriminatory and violates 4 U.S.C. § 111 and constitutional principles of intergovernmental tax immunity as discussed and applied in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989). (J.A. 42-43). Petitions sought a declaratory judgment invalidating the relevant provisions of the KITA, a permanent injunction prohibiting respondents from further enforcement thereof, and refunds of all Kansas income tax paid on petitioners' military retired pay since the 1984 tax year. (J.A. 47).

The Kansas income tax scheme

Kan. Stat. Ann. § 79-32,117 (Supp. 1990) provides that an individual's Kansas adjusted gross income shall be his or her federal adjusted gross income with certain modifications. Kansas adjusted gross income, less deductions and personal exemptions, constitutes Kansas taxable income. Kan. Stat. Ann. § 79-32,116 (1989). The appropriate income tax rate is applied to Kansas taxable income to determine

an individual's Kansas income tax liability. Kan. Stat. Ann. § 79-32,110 (1989).

Both military retired pay and retirement benefits paid by the State of Kansas and its political subdivisions are included in federal adjusted gross income and subject to federal income tax. 26 U.S.C. § 61(a) (1988). Retirement benefits paid by the State and its political subdivisions are specifically exempt from Kansas income tax[2] and federal adjusted gross income is modified to exclude such amounts in determining Kansas adjusted gross income. Kan. Stat. Ann. § 79-32,117(c)(ii) (Supp. 1990). There is no corresponding modification to exclude military retired pay. The result is that state and local government retirement benefits are exempt from Kansas income tax while military retired pay is taxable.[3]

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[2] Kan. Stat. Ann. § 12-111a (1982), § 12-5005 (Supp. 1990), § 13-14a10 and § 14-10a10 (1982) [exempting benefits paid to retired policemen and firemen under local retirement plans]; Kan. Stat. Ann. § 20-2618 (Supp. 1990) [exempting benefits paid under the retirement system for state judges]; Kan. Stat. Ann. § 72-1768a (1985) [exempting benefits paid under the school employee's retirement system]; Kan. Stat. Ann. § 74-4923(b) (Supp. 1990) [exempting retirement benefits paid under the Kansas Public Employees Retirement System ("KPERS") and Kansas Police and Fireman's Retirement System ("KP&F")]; Kan. Stat. Ann. § 74-4978g (Supp. 1990) [exempting highway patrol pension fund benefits payable under KP&F]; Kan. Stat. Ann. § 79-32,117(c)(ix) (Supp. 1990) [exempting benefits paid to retired city employees]; Kan. Stat. Ann. 79-32,117(c)(xiii) (Supp. 1990) [exempting benefits paid to retired employees of boards of public utilities].

[3] The State of Kansas first enacted an income tax in 1933. In 1961, the Kansas Legislature created the Kansas Public Employees Retirement System ("KPERS") and enacted an income tax exemption for both KPERS benefits and federal civil service retirement benefits. 1961 Kan. Sess. Laws, ch. 427, §§ 1, 3, 23; ch. 453, § 1. Amounts received as supplemental annuities by federal railroad retirees were later specifically exempted from Kansas

There are, however, two qualifications to this general

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income tax. 1973 Kan. Sess. Laws, ch. 398, § 1.

In 1971, the Legislature rejected a proposal to exempt military retired pay from Kansas income tax. H.B. No. 1193 (1971). Two years later a provision was enacted permitting military retirees over age 65 to exclude from Kansas adjusted gross income up to $2,000 received as retirement benefits for services in the armed forces. 1973 Kan. Sess. Laws, ch. 398, § 1. Proposals to increase the allowable exclusion for military retirement benefits were rejected in 1975, 1978 and 1981. S.B. No. 122 (1975); H.B. No. 2704 (Amended) (1978); S.B. No. 2 (1981). In 1982, the $2,000 exclusion was repealed and replaced by a $120 income tax credit for military retirees age 62 or older. 1982 Kan. Sess. Laws, ch. 409, §§ 1, 2. Proposals to abandon the $120 credit in lieu of a substantially increased exemption for amounts received as military retired pay were rejected in 1986 and 1988. S.B. No. 567 (1986); S.B. No. 520 (1988). In 1990, a proposal to abandon the $120 income tax credit in lieu of a total exemption for all amounts received as military retired pay was rejected. S.B. No. 423 (1990). In 1991, the Legislature approved a bill which would have exempted all amounts received as military retired pay. Sen. Sub. for H.B. No. 2122 (1991). The measure was vetoed by the Governor and an attempted override was unsuccessful.

On three occasions since 1977 the Legislature has empaneled a Special Committee on Assessment and Taxation to make findings and recommendations regarding the taxation of pensions and retirement benefits, including military retired pay. Reports compiled by these committees were considered in connection with the many proposals relating to the income tax treatment of military retirees. Report on Kansas Legislative Interim Studies to the 1978 Legislature, Special Committee on Assessment and Taxation, Vol. II, pp. 376-385 (1977); Report on Kansas Legislative Interim Studies to the 1981 Legislature, Special Committee on Assessment and Taxation, pp. 54-66 (1980); Report on Kansas Legislative Interim Studies to the 1990 Legislature, Special Committee on Assessment and Taxation, pp. 131-134 (1989). Unquestionably, the taxation of military retired pay has been one of the most prominent and persistent issues faced by the Kansas Legislature in the last 20 years.

rule. First, the Kansas Public Employees Retirement System ("KPERS") is a contributory retirement system in which participating employees make mandatory contributions to their retirement fund each payroll period. Kan. Stat. Ann. § 74-4919(1) (Supp. 1990). Although these contributions are "picked up" by the employer [Kan. Stat. Ann. § 74-4919(2)(a) (Supp. 1990)], and not subject to federal income tax [26 U.S.C. § 72(o) (1988)], they are required to be added to federal adjusted gross income for purposes of determining Kansas adjusted gross income and are thereby subject to Kansas income tax in the year in which they are made. Kan. Stat. Ann. § 79-32,117(b)(vi) (Supp. 1990). Thus, when KPERS benefits are paid out upon retirement, that portion of the benefits attributable to employee contributions has already been subject to Kansas income tax. Second, military retirees age 62 or older who receive military retirement benefits are entitled to claim a $120 credit against their Kansas income tax liability. Kan. Stat. Ann. § 79-32,111b(a) (1989). Therefore, certain members of the class represented by petitioners pay tax on only a portion of their military retired pay.

Disposition in the courts below

Petitioners moved for summary judgment arguing that the taxation of military retired pay under the KITA was invalid as a matter of law. (J.A. 57). The trial court rejected petitioners' claims finding that there were substantial differences between military retirees and retired state and local government employees which justified different tax treatment and that the KITA did not violate 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity. (J.A. 68). Petitioners' motion was denied and judgment entered for respondents. (J.A. 69-70). Petitioners appealed to the Court of Appeals of the State of Kansas (J.A. 70), and their motion to transfer the appeal to the

Supreme Court of the State of Kansas was subsequently granted.

In a unanimous decision published at 249 Kan. 186, 815 P.2d 46 (1991), the Kansas Supreme Court affirmed the trial court's decision. The court held that the taxation of federal military retirement benefits under the KITA meets the requirements of *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989), and that the KITA does not discriminate against federal military retirees in a manner that violates 4 U.S.C. § 111 (1988) and constitutional principles of intergovernmental tax immunity. (Pet. App. 1a).

SUMMARY OF ARGUMENT

This case can be decided on narrow grounds by application of the recent precedent in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989), or on broad policy grounds by reference to the constitutional doctrine of intergovernmental tax immunity and its statutory counterpart, 4 U.S.C. § 111. Either approach yields the same result: the taxation of nondisability military retired pay under the Kansas Income Tax Act [Kan. Stat. Ann. § 79-3201 *et seq.* (1989) ("KITA")], is valid because it does not discriminate against federal military retirees in violation of the Constitution and laws of the United States.

1. It is undisputed that the State of Kansas has the authority to tax the compensation paid by the Federal Government to military retirees residing in Kansas. The only prohibition is that the tax may not discriminate "because of the source of the pay or compensation." 4 U.S.C. § 111. The KITA provides that military retired pay is taxable while retirement benefits paid by the State of Kansas and its political subdivisions are exempt from Kansas income tax. However, this differential tax treatment is permissible because it is "directly related to and justified by 'significant

differences between the two classes' " of taxpayers. *Davis*, 489 U.S. at 816.

The manner in which Congress has chosen to regulate the United States Armed Forces causes military retirees to be uniquely situated in relation to all other retirees and gives rise to the significant differences between the two classes. Military retirees remain members of the armed forces and retain their military status. *United States v. Tyler*, 105 U.S. (15 Otto) 244 (1881). Unlike state and local government retirees, who do not continue employment in a reduced or contingent capacity and are not required to perform any additional duties, military retirees continue to be employed by the Federal Government and have continuing obligations in connection with their employment. Further, while state and local government pension benefits are deferred compensation for prior services, military retired pay is "reduced compensation for reduced current services" which "differs in some significant respects from a typical pension or retirement plan." *McCarty v. McCarty*, 453 U.S. 210, 221-222 (1981).

For these reasons, the differential tax treatment at issue is based on actual and substantial differences between the two classes of taxpayers and not on the federal source of military retired pay. The fact that certain federal retirement benefits other than military retired pay are exempt from Kansas income tax is further evidence that the KITA is not designed to discriminate against federal retirees.

2. The purpose of the implied constitutional doctrine of intergovernmental tax immunity is to prevent undue interference with the operations of one government by imposing on it the tax burdens of the other. *Graves v. New York ex rel. O'Keefe*, 306 U.S. 466, 483-484 (1939). The taxation of military retired pay does not impose either a legal or economic burden on the Federal Government. Further,

neither the petitioners nor the United States, as *amicus curiae* in support of petitioners, have alleged that the tax on military retired pay actually interferes with the operations of the Federal Government.

Consistent with constitutional and statutory principles of federal tax immunity, a State may impose a nondiscriminatory income tax on compensation paid to federal retirees. The exemption for state and local government retirement benefits does not cause the taxation of military retired pay to be discriminatory. In light of the manifold differences between these two classes of taxpayers, they are not "similarly situated consitutents" of the State of Kansas and federal law does not require that they be taxed in the same manner. *United States v. County of Fresno*, 429 U.S. 452 (1977). Military retirees are adequately protected against discriminatory state taxation because they themselves participate and are represented in the state political process and they receive the same tax treatment as private sector retirees.

Under both the Constitution and 4 U.S.C. § 111, the scope of federal tax immunity is very narrow when asserted by federal officers and employees to defeat a state income tax imposed on their pay or compensation. To construe the immunity as requiring equal tax treatment of two classes of taxpayers as dramatically different as these here would be an unreasonably broad construction, and would result in a corresponding curtailment of a State's right to exercise its sovereign power of taxation and order its own affairs.

ARGUMENT

THE TAXATION OF FEDERAL NONDISABILITY MILITARY RETIRED PAY UNDER THE KANSAS INCOME TAX ACT DOES NOT VIOLATE 4 U.S.C. § 111 AND THE CONSTITUTIONAL DOCTRINE OF INTERGOVERNMENTAL TAX IMMUNITY.

A. The differential tax treatment of military retirees and retired state and local government employees is directly related to and justified by significant differences between the two classes and is consistent with this Court's decision in *Davis v. Michigan Department of Treasury.*

This action was filed as a direct response to the decision in *Davis v. Michigan Department of Treasury,* 489 U.S. 803 (1989), where a state income tax scheme favoring retired state and local government employees over retired federal civil service employees was declared invalid. 489 U.S. at 817. This Court found that the differential tax treatment was not directly related to and justified by significant differences between the two classes of taxpayers and therefore violated 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity. 489 U.S. at 816-817.

This case involves military retirees, not federal civil service retirees, and raises issues not presented in *Davis.* There are significant differences between military retirees and retired state and local government employees and the differential tax treatment at issue is directly related to and justified by those differences. In essence, Kansas succeeds where Michigan failed.

1. There are significant differences between military retirees and retired state and local government employees.

The mission of the United States Armed Forces—to wage war and maintain national security—is unlike that of civilian government and private industry. The armed forces must be prepared to commence military operations at a moment's notice and the availability of skilled personnel must be assured. Disciplinary measures are required to maintain an adequate level of preparedness and insure efficiency in the chain of command. Congress has addressed these vital concerns by implementing personnel management methods for members of the armed forces that have no parallel elsewhere in the public or private sector. The unique purpose and function of military retirees causes both their status and the character of their compensation to differ substantially from that of all other retirees.

a. Military retirees remain in the military service of the United States.

In *United States v. Tyler*, 105 U.S. (15 Otto) 244 (1881), this Court stated that a retired United States Army officer remains in the military service and is "by law a part of the army." 105 U.S at 246. Retirement from active service is "manifest[ly] differen[t]" than "retiring wholly and altogether from the service." *Id.* at 245. While not required to perform full service, a retired officer is part of the army and may be assigned to duty. The names of retired officers are maintained on the Army Register, they are entitled to wear their military uniforms and they are subject to the rules and articles of war and trial by court-martial. *Id.* at 246. The Court stated "it is impossible to hold that * * * (retired officers) * * * are still *not* in the military service." *Id.* (Emphasis in original). Their retirement pay is "compensation continued at a reduced rate, and the connection (with the military service) is continued with a retirement from active service only." *Id.* at 245.

The Court's findings in *Tyler* over a century ago continue to be true today under current provisions of federal law[4] and subsequent decisions of all federal courts that have addressed the status of military retirees.[5]

Military retirees do not remain in the armed forces as a mere formality[6] nor is the involuntary recall of military

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[4] The Regular Army includes retired officers and enlisted personnel, 10 U.S.C. § 3075(b)(3); the Secretary of the Army shall maintain a list of all retired officers, warrant officers and enlisted personnel, 10 U.S.C. § 3966; retired officers may wear their military uniforms, 10 U.S.C. § 772(c); all retired members of the Regular Army are subject to involuntary recall to active duty, 10 U.S.C. § 688(a); retired members of the armed forces entitled to receive pay are subject to the Uniform Code of Military Justice and court-martial jurisdiction, 10 U.S.C. § 802(a)(4). Each branch of the armed forces has substantially the same nondisability retirement system. *McCarty v. McCarty*, 453 U.S. 210, 213 (1981).

[5] *See e.g., Watson v. Watson*, 424 F. Supp. 866, 868 (E.D.N.C. 1976) ("In effect, the defendant continues to hold the same office, that is, a retired colonel, that he held while he was on active duty, and he continues to receive compensation for this employment."); *Chambers v. Russell*, 192 F. Supp. 425, 427 (N.D. Cal. 1961) ("[A] retired officer entitled to receive pay is not so divorced from the military to be considered a mere civilian, but is part of the military and has military status."); *Lemly v. United States*, 75 F. Supp. 248, 249 (Ct. Cl. 1948) ("Even though an officer is retired from active duty and is receiving retirement pay * * * he is still an officer in service of his country even though on the retired list."); *Hostinsky v. United States*, 292 F.2d 508, 510, 154 Ct. Cl. 443 (1961) ("We think than an officer in the Navy, though retired, is still an officer.").

[6] Numerous sections of Title 10 of the United States Code refer to retired lists or state that military retirees are part of the service branch from which they retire. 10 U.S.C. § 3075 (Regular Army includes retired officers and enlisted members); 10 U.S.C. § 3966 (Secretary of the Army shall maintain a list of all retired officers, warrant officers and enlisted members); 10 U.S.C. § 6331 (transfer from Fleet Reserve or Fleet Marine Corps Reserve to retired list

retirees an abstract theory.[7] One of the primary purposes of the military retirement system is to maintain "a pool of experienced military manpower that can be called upon in time of war or national emergency to augment the active-duty forces of the United States." *Military Compensation Background Papers: Compensation Elements and Related Manpower Cost Items—Their Purposes and Legislative Backgrounds,* (3rd ed. 1987) at 367 ("*Military Compensation Background Papers*"). The involuntary recall of military retirees in connection with United States military operations in the Persian Gulf illustrates their vital role in our system of national defense.

Consistent with their continuing status as officers and employees of the United States, military retirees are entitled to various privileges and employee benefits not available to other retirees and members of the general public. These include free or subsidized medical and dental care [10 U.S.C. §§ 1074(b), 1076(b), 1086], free travel on military

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of Regular Navy or Regular Marine Corps); 10 U.S.C. § 6483 (pertaining to retired naval officers recalled to active duty); 10 U.S.C. § 8075 (Regular Air Force includes all retired officers and enlisted members); 10 U.S.C. § 8966 (Secretary of the Air Force shall maintain retired list of all retired officers, warrant officers and enlisted members).

[7] *Cf. Chambers v. Russell,* 192 F.Supp. 425, 428 (N.D. Cal. 1961) ["an officer of the United States in retired military status may reasonably be expected to * * * hold himself ready and fit for recall to active duty, in so far as he is subject to an involuntary return to service in the event of war or national emergency."]; *Hooper v. United States,* 326 F.2d 982, 987 (Ct. Cl. 1964), *cert. denied,* 377 U.S. 977 (1964) ["The salary (a retired Navy Officer) received was not solely recompense for past services, but a means devised by Congress to assure his availability and preparedness in future contingencies. He has a direct connection with the operation of the 'land and naval forces.' Thus, he formed a part of a vital segment of our national defense."].

aircraft [*Handbook on Retirement Services for Army Personnel and Their Families*, DA PAM 600-5, at 6 (1982)] and authorization to shop at military commissaries [10 U.S.C. § 4621 (Army), § 7601 (Navy and Marines), § 9621 (Air Force)].

Military retirees are also subject to substantial restrictions on their post-retirement activities. Because they remain members of the armed forces, the Federal Government has a legitimate interest in regulating their conduct and activities. Retired officers are prohibited from employment with any foreign government [U.S. Const. Art. I, Sec. 9, Cl. 8], and from working for defense contractors within three years after retirement [37 U.S.C. § 801]. Their retirement pay may be reduced if they take other employment with the Federal Government. 5 U.S.C. § 5532. The court-martial jurisdiction of the Uniform Code of Military Justice extends to offenses committed by military retirees subsequent to retirement [10 U.S.C. § 817(a)], and military retired pay may be forfeited upon conviction for certain crimes [5 U.S.C. § 8312].

In stark contrast, retired state and local government employees have no continuing connection with their former employer. They are completely severed from employment, they are not subject to involuntary recall to active duty, they are not subject to any personnel procedures or disciplinary rules and regulations and they are not entitled to any benefits otherwise available to current employees. (J.A. 58-59).

Military retirees remain in the military service of the United States. They do not become civilians when they retire from active duty nor are they discharged from the armed forces. Upon retirement their employment status changes but it does not terminate. They are required to perform certain duties and failure to perform those duties

may result in termination of their retired pay. *Matter of Haynes*, 679 F.2d 718, 719 (7th Cir. 1982), *cert. denied sub nom. Miller v. Haynes*, 459 U.S. 970 (1982). Retired state and local government employees do not continue employment in a reduced or contingent capacity nor are they required to perform any additional duties in order to receive their retirement benefits. (J.A. 61).

In a 1987 report, the United States Department of Defense stated:

> It should be noted that, while there may be a superficial resemblance between the military retirement system and retirement systems that exist in the private sector, *there are in fact substantial differences between the military retirement system and all other retirement systems*—including that of Federal civil servants. *Military Compensation Background Papers*, at 367 (emphasis added).

Plainly, "the military retirement system is unique to all other retirement systems." (J.A. 68). It is different from KPERS and all other state and local government retirement systems. The "substantial differences" noted by the Department of Defense compel the conclusion that there are "significant differences" between the two classes of taxpayers.

b. Military retired pay is current pay for current services.

Since the military retirement system is substantially different than all other retirement systems, it is unsurprising that there are significant differences between military retired pay and state and local government retirement benefits.[8] As stated in *Tyler*, military retired pay is "compen-

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[8] For persons joining the armed forces prior to September 8, 1980, (which includes all members of the class represented by petitioners) retired pay is calculated pursuant to a statutory for-

sation * * * continued at a reduced rate, and the connection is continued, with a retirement from active service only." 105 U.S. at 245. In *McCarty v. McCarty*, 453 U.S. 210, 222 (1981), this Court stated that "military retired pay is reduced compensation for federal current services."[9]

In *Davis* it was determined that federal civil service retirement benefits are "deferred compensation for past years of service rendered to the Government." 489 U.S. at 808 (citations omitted). However, military retired pay is not deferred compensation or a pension. It "differs in some significant respects from a typical pension or retirement plan." *McCarty*, 453 U.S. at 221.[10]

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mula and may not exceed 75 percent of the basic pay of the retired grades of the service member. 10 U.S.C. § 1401; *Military Compensation Background Papers*, at 373. A minimum of 20 years of service is required to be eligible to retire and receive military retired pay. Retirees may immediately begin to draw full retirement pay without a minimum age requirement. 10 U.S.C. §§ 3911, 3914 (Army), §§ 6323, 6330 (Navy and Marines), §§ 8911, 8914 (Air Force) *Military Compensation Background Papers*, at 381, 385. Retired pay is adjusted annually based on the Consumer Price Index. 10 U.S.C. § 1401a.

[9] *Cf. Costello v. United States*, 587 F.2d 424, 427 (9th Cir. 1978), *cert. denied*, 442 U.S. 929 (1979) ("[R]etired pay does not differ from active duty pay in its character as pay for continuing military service."); *United States v. Tafoya*, 803 F.2d 140, 142 (5th Cir. 1986) (Unlike most forms of federal retirement pay, military retired pay is "current pay" designed in part to compensate military retirees for their continued readiness to return to duty.).

[10] *See, e.g., In re Siverling*, 72 Bankr. 78, 79 (W.D. Mo. 1987) ("Military retirement is more like wages than a pension."); *Berkey v. United States*, 361 F.2d 983, 987 n.9 (Ct. Cl. 1966) (military retired pay is not a pension, grant or gratuity.); *Hooper v. Hartman*, 163 F.Supp. 437, 441 (S.D. Cal. 1958), *aff'd* 274 F.2d 429 (9th Cir. 1959) (pay received by a retired Navy officer "is not a pension or annuity, but is an emolument of and dependent upon the office so held.").

It is undisputed that retirement benefits paid by the State of Kansas and its political subdivisions are deferred compensation for prior service rather than current compensation for current service. State and local government retirement benefits are funded by regular employee and employer contributions made during the period of employment and investment earnings thereon. Kan. Stat. Ann. §§ 74-4919(1) (Supp. 1990), 74-4921(1) (Supp. 1990). (J.A. 60). In contrast, the military retirement system is noncontributory. No periodic contributions are made to any retirement fund by either the service member or the Federal Government during the period of active service. Instead, military retired pay is fully funded by annual appropriations from Congress. *McCarty*, 453 U.S. at 214; 10 U.S.C. §§ 1461-1467; *Military Compensation Background Papers*, at 381.

Employee contributions to KPERS are subject to Kansas income tax in the year in which they are made and KPERS benefits include these previously taxed contributions. Kan. Stat. Ann. § 79-32,117(b)(vi) (Supp. 1990). In contrast, no portion of military retired pay is taxed by the State of Kansas before such benefits are paid out to military retirees. (Pet. App. 26a).

Depending upon their age at induction, it is possible for members of the armed forces to retire and draw full benefits prior to age 40. In contrast, the normal retirement age for KPERS members is age 65. Kan. Stat. Ann. § 74-4914(1) (Supp. 1990). KPERS members may retire as early as age 55 but they do not receive full benefits nor do their benefits increase when they attain age 65. Kan. Stat. Ann. §§ 74-4914(5) (Supp. 1990), 74-4914(2) (Supp. 1990).[11] Con-

[11] Certain correctional employees may retire with full benefits at age 55 or take early retirement with reduced benefits at age

versely, entitlement to military retired pay is an "all or nothing proposition. * * * The military retirement system, in marked contrast to private-sector and Civil Service retirement systems, does not provide for the gradual vesting of retirement benefits." *Military Compensation Background Papers*, at 368.

In summary, this Court has stated that "military retired pay *differs in some significant respects* from a typical pension or retirement plan." *McCarty*, 453 U.S. at 221 (emphasis added).[12] Petitioners themselves concede that "military retirement benefits are unique in comparison to other federal retirement benefits." (Pet. App. 29a). In ruling on the merits, the court below placed principal reliance on the fact that military retired pay is current compensation for current services and reasoned that a State is justified in taxing current compensation while not taxing deferred compensation. (Pet. App. 30a). Clearly, there are significant differences between the two classes of taxpayers based on the character of their compensation.

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50. Kan. Stat. Ann. § 74-4914c (Supp. 1990). Police and firemen may retire with full benefits at age 55 with 20 years of service or take early retirements with reduced benefits at 50 with 20 years of service. Kan. Stat. Ann. §§ 74-4957, 74-4957a (Supp. 1990).

[12] Petitioners urge the Court to disregard *McCarty* because it is a "nontax case." (Pet. Br. at 8, 20). However, they cite repeatedly to *McCarty* to support their claim that military retired pay is a "pension" for federal income tax purposes. (Pet. Br. at 8-9; 27-29). However, *McCarty* states only that military retired pay "is taxable as ordinary income when received." 453 U.S. at 214 n.7. The authorities cited do not state that military retired pay is a pension. 26 U.S.C. § 61(a)(11); 26 C.F.R. § 1-61-11 (1980). In fact, Treas. Reg. § 1.61-2(a) (1991) provides that "pay of persons in the military or naval forces of the United States, *retired pay of employees*, pensions and retirement allowances" are taxable as compensation for services in the same manner as wages and salaries. (Emphasis added).

2. The differential tax treatment of military retired pay is "directly related to and justified by" significant differences between the two classes of taxpayers.

As demonstrated above, there are significant differences between military retirees and retired state and local government employees in the terms and conditions of their retirement and in the character of their compensation. As required by *Davis*, the differential tax treatment of military retired pay is "directly related to and justified by" these significant differences and is therefore valid. 489 U.S. at 816.

a. The taxation of military retired pay is "directly related to" significant differences between the two classes of taxpayers.

In *Davis* the State of Michigan argued that a tax imposed on federal civil service retirement benefits but not on state and local government retirement benefits was valid because most federal retirees receive a larger pension than their state counterparts. 489 U.S. at 816-817. However, this alleged difference did not hold true in all instances; certain exempt state and local government pensions were larger than certain taxable federal pensions. *Id.* at 817. Hence, the differential tax treatment was not "directly related to" the purported justification. Here, however, the differences between those receiving military retired pay and state and local government retirement benefits "are common to all members of each class." (Pet. App. 28a).

All military retirees remain members of the armed forces and are regulated as such whereas all state and local government retirees are completely severed from employment and have no continuing connection with their former employer. All military retirees receive current pay for current services whereas all state and local government retirees receive deferred compensation for prior services. Thus, "an

evenhanded application of the rationale" for taxing military retirees does not result in the taxation of any state and local government retirees. *Davis*, 489 U.S. at 817, citing *Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U.S. 376, 384-385 (1960). For this reason, the differential tax treatment of military retired pay is "directly related to" the differences between the two classes of taxpayers and satisfies the first prong of the *Davis* test.

Petitioners' arguments to the contrary are crafted in a clever, yet ultimately unpersuasive, manner. Their central premise is as follows: the reasons proffered to support differential taxation of military retirees do not also support the taxation of other federal retirees, thus the taxation of military retirees is not directly related to the purported differences but is based on the federal source of military pay. (Pet. Br. 19-27). This theory explains the subtle shift in petitioners' argument from an initial focus on the differences between military retirees and retired state and local government employees to a comparison of "favored and disfavored government retirees." (Pet. Br. 19). It is only in this manner that petitioners are able to argue that the status and characteristics of other federal retirees, whose interests are not at issue here, have any bearing on the question presented.[13]

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[13] Petitioners would have been hardpressed to include some of the other federal retirees in their petition filed in April, 1989. The retirement system for Court of Claims judges under 28 U.S.C. § 178 was created in December, 1990, by the enactment of Pub. L. 101-650, Title III, § 306, 104 Stat. 105, over a year and a half after the petition was filed. Prior to the 1990 legislation, Claims Court judges were under the federal civil service retirement system. H.R. Rep. No. 101-374, 101st Cong. 2d Sess., at 26 (1990). The retirement system for federal magistrates and bankruptcy judges under 28 U.S.C. § 377 was added by Pub. L. 100-659, § 2(a), Nov. 15, 1988, 102 Stat. 3910. Prior to this new re-

This approach fails because it does not address the allegations upon which this action is based. Petitioners' claims rest squarely on the lack of any significant differences between military retirees and retired state and local government employees. (J.A. 11-12; 42-43). There is a conspicious absence in the pleadings of any reference to the taxation of other federal retirement benefits or any intimation that the tax treatment of other federal retirees is relevant to the validity of the taxation of military retirees.

The realities encountered in the course of this litigation explain the transformation in petitioners' theory of the case. The *Davis* decision was handed down on March 28, 1989. Without making adequate inquiry, petitioners automatically assumed that the taxation of military retired pay was invalid for the same reasons the taxation of federal civil service retirement benefits was held invalid in *Davis*. Petitioners had two powerful incentives to file suit at the earliest possible opportunity. First, to claim income tax refunds for the 1984 tax year prior to the expiration of the statute of limitations on April 17, 1989. Second, to win the "race to the courthouse" and be first in line to seek certification of this matter as a class action. In their haste, petitioners overlooked the unique status of military retirees in relation to all other retirees that has long been recognized by a host of authorities, including this Court and the Federal Government. Respondents subsequently brought these dif-

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tirement system created in November, 1988, magistrates and bankruptcy judges were under the federal civil service retirement system. S. Rep. No. 100-293, 100th Cong., 2d Sess., at 3 (1988); H.R. Rep. No. 100-638, Part 1, 100th Cong., 2d Sess., at 9 (1988). Respondents have determined that only one federal magistrate from the District of Kansas has retired. He retired in 1985 under the federal civil service system and his retirement benefits are therefore exempt from Kansas income tax. Kan. Stat. Ann. 79-32,117(c)(vii) (Supp. 1990).

ferences to light and were granted summary judgment on the merits. Petitioners then had no option but to abandon their original position and attempt to analogize the plight of military retirees to that of other federal retirees whose retirement benefits are also subject to Kansas income tax. This approach might merit consideration if the class they represent included these other federal retirees, but it does not. Consequently, petitioners have been reduced to arguing issues other than those raised in the pleadings on behalf of taxpayers whom they do not represent.

The Kansas Supreme Court correctly concluded that the taxation of other federal retirees was immaterial to the validity of the taxation of military retirees. (Pet. App. 29a). This conclusion rested in part on petitioners' concession that "military retirement benefits are unique in comparison to other federal retirement benefits." *Id.* Petitioners' acknowledgment of the special status of military retirees detracts from their analysis of the differences between "favored and disfavored government retirees." Because military retirees are unique and thus unlike other "disfavored government retirees," they should not be grouped together to determine if they as a class are significantly different than those that are "favored." The court below reserved for another day questions regarding the taxation of other federal retirees. (J.A. 29a). This Court should likewise decline to address issues that are beyond the scope of the pleadings and not fairly embraced in the question presented.

Respondents agree that the justifications supporting taxation of military retirees do not necessarily support the taxation of other federal retirees.[14] Due to their unique

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[14] The classification of retirees of the Public Health Service (PHS) and the National Oceanic and Atmospheric Administration (NOAA) with military retirees may be appropriate. Section

status, the differences between military retirees and retired state and local government employees are more extensive and profound than those between retired state and local government employees and any other class of federal retirees. Given the singular status of military retirees, the taxation of other federal retirees does not affect whether the taxation of military retired pay is valid. Due to their special standing in relation to the Federal Government and the manner in which they are treated by Congress, military retirees are uniquely situated and petitioners' attempts to group them with other federal retirees are unavailing.

The Court should examine "the whole tax structure of the state" in considering the validity of the Kansas income tax treatment of military retirees. *Phillips Chemical Co.*, 361 U.S. at 383, citing *Tradesmens Nat. Bank v. Oklahoma Tax Commission*, 309 U.S. 560, 568 (1940). But, in the final analysis, such an examination reveals only that Kansas taxes

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101(43) of Title 10 of the United States Code defines uniformed service as the Army, Navy, Air Force, Marine Corps, Coast Guard, PHS, or NOAA. *Accord* 5 U.S.C. § 8331(13); 42 U.S.C. § 201(p). Other statutes pertaining to the PHS include: 42 U.S.C. § 212(c) (retired officers subject to involuntary recall); 42 U.S.C. 213a (commissioned officers entitled to rights, benefits, privileges and immunities provided for Army commissioned officers); 42 U.S.C. § 210(b) (retired officers entitled to commissary and post exchange privileges); 42 U.S.C. § 217 (in time of war or emergency President can subject commissioned corps to Uniform Code of Military Justice); 42 U.S.C. § 213(a) (eligibility for military benefits). Other statutes pertaining to NOAA include: 33 U.S.C. § 864 (all laws relating to retirement of commissioned Navy officers apply to commissioned officers of NOAA); 33 U.S.C § 857-2 (retired list and recall from retirement); 33 U.S.C. § 853o (references retirement pay to member of Armed Forces under 10 U.S.C. §§ 101, 1405, 1406, 1407, 1409); 33 U.S.C. §§ 857, 857-3 (eligibility for servicemen's and veteran's benefits); 33 U.S.C. § 857-4 (commissary privileges).

certain federal retirement benefits and does not tax others.[15] For example, unlike the Michigan statutory scheme at issue in *Davis*, federal civil service retirement benefits are exempt from taxation under the KITA. Kan. Stat. Ann. § 79-32,117(c)(vii) (Supp. 1990). Since the Federal Government is the source of both federal civil service retirement benefits and military retired pay, the fact that the former is exempt while the latter is taxable belies petitioners' claim that the taxation of military retired pay is based on its source. Since other benefits from the same source are exempt, the basis for taxation of military retired pay must rest elsewhere.

Further examination of the manner in which all retirement benefits are taxed under the KITA reveals no broad purpose or intent to discriminate against federal retirees generally. Federal civil service retirees are favored above all other retirees, including state and local government employees. Not only are federal civil service retirement benefits exempt from taxation, there is no tax on employee contributions to the Federal Civil Service Disability and Retirement Fund. In contrast, employee contributions to KPERS are taxable in the year in which they are made. Kan. Stat. Ann. § 79-32,117(b)(vi) (Supp. 1990). Also, military retirees age 62 or older receive a $120 income tax credit that is not available to any other class of retirees. Taken as a whole, it is difficult to conclude that the KITA

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[15] Kansas does not tax federal civil service retirement benefits [Kan. Stat. Ann. § 79-32,117(c)(vii) (Supp. 1990)] or retired railroad supplementary annuities [Kan. Stat. Ann. § 79-32,117(c)(viii) (Supp. 1990)]. Kansas also does not tax Tier I railroad retirement benefits, all or portions of social security benefits, military disability retired pay, Veterans Administration pensions, and disability annuities from the PHS, NOAA and Foreign Service retirement systems. These benefits are excluded from both Federal and Kansas adjusted gross income. 26 U.S.C. §§ 86, 104; 38 U.S.C. § 5301; Kan. Stat. Ann. § 79-32,117(a) (Supp. 1990).

is designed to place federal retirees at a disadvantage vis-a-vis other retirees, public or private.

b. The taxation of military retired pay is "justified by" significant differences between the two classes of taxpayers.

In *Davis*, the State argued that its interest in hiring and retaining qualified civil servants was sufficient to justify a tax scheme favoring retired state and local government employees over retired federal civil service employees. 489 U.S. at 816. Michigan's argument was rejected on two counts. First a mere "rational reason" for discriminating between the two classes of taxpayers was insufficient; an equal protection analysis does not apply when a tax is alleged to violate the doctrine of intergovernmental tax immunity. The relevant inquiry is whether the inconsistent tax treatment is directly related to and justified by significant differences between the two classes, which is a more stringent standard of review than the rational basis test. *Id.* Second, the State's interest in adopting the discriminatory tax "is simply irrelevant to an inquiry into *the nature of the two classes* receiving inconsistent treatment" (citations omitted), and "does nothing to demonstrate that there are *'significant differences between the two classes' themselves.*" 489 U.S. at 816 (emphasis added). These principles are equally applicable here.

The Kansas Supreme Court identified and applied the correct standard of review[16] and expressly noted that it is a higher standard than a mere rational basis. (Pet. App. 34a-35a). The court also determined that differential tax

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[16] "The crucial issue in the case at bar is whether the inconsistent tax treatment of federal military retirement benefits is "directly related to, and justified by, 'significant differences' " between federal military retirees and state and local government retirees." (Pet. App. 15a).

treatment of military retirees is justified by actual differences between the two classes themselves, not merely by considerations designed to further legitimate state interests. The court based its ruling on the unbroken line of federal authority holding that military retired pay is reduced current compensation for reduced current services and stated, "[a] state is justified in taxing reduced current compensation for reduced current services while not taxing deferred compensation." (Pet. App. 30a).

The characterization of military retired pay as current pay for current services is amply supported by the authorities cited in the opinion below and those discussed *supra* at 15-18. The Kansas Supreme Court noted, but declined to follow, various decisions of other state courts treating military retired pay as deferred compensation.[17] (Pet. App. 30a). The court was clearly correct in relying on the federal precedents.

Pursuant to Art. I, Sec. 8 of the Constitution, Congress has authority to establish and regulate the armed forces of the United States.[18] There is no area in which Congress is entitled to greater deference than in the conduct and control of military affairs. *McCarty*, 453 U.S. at 236. Pursuant to this authority, Congress has enacted a comprehensive statutory scheme providing for the retirement of members of the armed forces. Except where Congress has otherwise

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[17] *Bohn v. Waddell*, 164 Ariz. 74, 790 P.2d 772 (T.C. 1990), *aff'd on reconsideration*, 82 Ariz. Adv. Rep. 52, 807 P.2d 1 (T.C. 191), *appeal pending*, No. 1 CA-TX 90-029 (Ariz. App. 1991); *Hackman v. Director of Revenue*, 771 S.W.2d 77 (Mo. 1989), *cert. denied*, 493 U.S. 1019 (1990); *Pledger v. Bosnick*, 306 Ark. 45, 811 S.W.2d 286 (1991), *pet. for cert. pending*, Case No. 91-375.

[18] Art. I, Sec. 8, Cl. 1; "The Congress shall have power * * * [12] to raise and support Armies * * * [13] to provide and maintain a Navy; [14] to make Rules for the Government and Regulation of the land and naval forces;"

provided, States are completely preempted from applying their local laws to military retired pay. *See McCarty*, 453 U.S. at 236 (State precluded for application of its community property laws to military retired pay.)

Congress determined that the decision in *McCarty* resulted in inequity to former spouses of military retirees and enacted the Uniform Services Former Spouses Protection Act, Pub. L. No. 97-252, 96 Stat. 730 (1982), ("USFSPA"), permitting States to treat military retired pay as community property for purposes of marital dissolution. *Mansell v. Mansell*, 490 U.S. 581, 584-585 (1989).[19] In 1987, Kansas adopted the USFSPA and amended its Married Persons Act, Kan. Stat. Ann. § 23-201 *et seq.* (1988), to treat military retired pay as marital property for this limited purpose.[20] Prior to this amendment, Kansas had held that military retired pay was not marital property but was merely a future stream of income which would cease at the death of the retiree. *Grant v. Grant*, 9 Kan. App. 2d 671, 676, 685 P.2d 327, *rev. denied* 236 Kan. 875 (1984).

The enactment of the USFSPA and the corresponding amendment to the Kansas Married Persons Act did not cause military retired pay to suddenly become deferred

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[19] *Mansell* held that the USFSPA did not authorize States to treat as community property military retired pay waived by a retiree in order to obtain disability benefits pursuant to 38 U.S.C. §§ 310, 331 (currently 38 U.S.C. §§ 1110, 1131).

[20] Kan. Stat. Ann. § 23-201(b) (1988) provides, *inter alia*:
All property owned by married persons, *including the present value of any vested or unvested military retirement pay*, whether described in subsection (a) or acquired by either spouse after marriage, and whether held individually or by the spouses in some form of co-ownership, such as joint tenancy or tenancy in common, shall become marital property at the time of commencement by one spouse against the other of an action for divorce, separate maintenance or annulment. (Emphasis added).

compensation.[21] In *Mansell*, the Court stated that Congress may override the characterization of military retired pay as current pay for current services only by enacting an affirmative grant of authority giving States the power to treat military retired pay otherwise, which it clearly has not done in this instance. 490 U.S. at 588. Further, as *McCarty* and *Mansell* indicate, the States' ability to treat military retired pay as marital property is attributable not to any state authority to regulate military retirees but to the grace of Congress, and that which Congress has granted may just as easily be withdrawn.

Petitioners argue that Kansas case law, statutes and administrative regulations purport to treat military retired pay as deferred compensation or a pension. (Pet. Br. 29-33, 39-40). However, even assuming that such authority exists, and assuming further that the characterization of military retired pay under state law should be preferred to that on the federal level, petitioners' argument is self-defeating. If the characterization of military retired pay as either current or deferred compensation is truly a question of state law, then it must be acknowledged that the highest court of the State of Kansas has, at least for purposes of this action, construed and characterized military retired pay as current compensation. If the court below erred in applying its local law, it is not this Court's role to substitute its judgment on matters beyond its sphere of competence. The better view, however, is that, in light of the exclusive federal authority over all aspects of the armed forces, the characterization of military retired pay expressed in *McCarty*

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[21] *United States v. Tafoya*, 803 F.2d 140, 142 n.7 (5th Cir. 1986) ("The discussion (in *McCarty*) regarding the classification of military retired pay as current pay remains valid."); *Cornetta v. United States*, 851 F.2d 1372, 1382 n.3 (Fed. Cir. 1988) (The USFSPA "did not affect the characterization of military retired pay as reduced compensation for reduced current services.").

is controlling and States are not at liberty to deviate therefrom.

In the Petition for Certiorari, petitioners allege that the decision below conflicts with decisions of other state courts of last resort. (Pet. 6-10). However, these other decisions either assumed military retirees are no different than federal civil service retirees[22] or relied upon state law precedents in the marital property area to conclude that military retired pay is deferred compensation[23] and, hence, not significantly different than state and local government retirement benefits. Several of these decisions await disposition by this Court on writ of certiorari and should be vacated and remanded for consideration in light of the decision to be entered herein.[24]

3. The taxation of military retired pay under the Kansas Income Tax Act is distinguishable from the taxation of federal civil service retirement benefits held invalid in *Davis v. Michigan Department of Treasury*.

As demonstrated above, there are significant differences between military retirees and retired state and local government employees and the differential tax treatment

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[22] *Bohn v. Waddell, supra; Hackman v. Director of Revenue, supra.*

[23] *Pledger v. Bosnick, supra; Kuhn v. Colorado,* 817 P.2d 101 (Colo. 1991), *pet. for cert. pending,* Case No. 91-980.

[24] *Id. See also Harper v. Virginia Department of Taxation,* ___S.E.2d ___(Va. 1991), *pet. for cert. pending,* Case No. 91-794 (issue regarding taxation of military retirees raised in petition for certiorari although not addressed in lower court's decision). The primary issue in *Harper* is whether federal retirees are entitled to receive refunds of income taxes paid prior to the decision in *Davis*. Respondents submit the Virginia Supreme Court, on remand from this Court, correctly determined that *Davis* does not apply retroactively, and that a State is not required to refund taxes collected under a statutory scheme that was valid at the time the tax was imposed.

at issue is directly related to and justified by those differences. There were no such differences between the two classes of taxpayers in *Davis*. Both federal civil service retirees and retired state and local government employees are fully and unconditionally retired from government service and have no continuing connection with their former employer. Both participate in contributory retirement programs and receive deferred compensation for prior services.

In *Davis* the differences between the two classes of taxpayers articulated by the State of Michigan were based on considerations of state policy, not on any actual differences "between the two classes themselves."489 U.S. at 816-817. Michigan simply perceived its interests could be advanced by treating the two classes differently and proceeded to structure its income tax scheme accordingly. In Kansas, a comprehensive examination of the military retirement system in conjunction with other retirement systems and pensions plans has resulted in an appreciation on the part of the Kansas Legislature of the unique status of military retirees.[25] This, in turn, has resulted in legislative measures providing for the taxation of military retired pay in a manner unlike that of any other form of retirement pay.[26] The Kansas tax treatment at issue is the product of a considered determination premised on appreciable differences between military retirees and all other retirees. It is not attributable to casual indifference to the status of military retirees or to a concerted effort to place military retirees at a relative disadvantage because the Federal Government is the source of military retired pay.

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[25] See n.3 *supra*.

[26] Kan. Stat. Ann. § 79-32,111b(a) (1989), provides a $120 income tax credit for military retirees age 62 or older that is unavailable to any other retirees.

Petitioners argue that all government employees, including military retirees, are similarly situated and "presumably should be taxed alike." (Pet. Br. 13-15). While it is true that military retirees and retired state and local government employees are both placed on "retired" status and receive retirement pay, this argument favors form over substance and ignores the many differences between the two classes. In reality, the concept of retirement for members of the armed forces is completely different than for civilian employees, and military retired pay "differs in some significant respects from a typical pension or retirement plan." *McCarty*, 453 U.S. at 221. Petitioners skirt these fundamental differences and rely upon a broad and overgeneralized characterization of the two classes to conclude they are similarly situated.

Even assuming these two classes of taxpayers are similarly situated, this merely raises, but does not answer, the question of whether differential tax treatment is permissible. In *Davis*, the Court did not conclude that the taxation of federal civil service retirement benefits was invalid simply because the two classes of taxpayers were both "retired" and received retirement pay. In fact, it was conceded that Michigan's income tax scheme discriminated in favor of retired state employees and against retired federal civil service employees. 489 U.S. at 814. But this was the beginning, not the end, of the judicial inquiry. The Court proceeded to consider whether "the State's inconsistent treatment of Federal and State Government retirees is justified by meaningful differences between the two classes." *Id.*[27]

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[27] *Cf. Phillips Chemical Co.*, 361 U.S. at 382 ("[T]he discrimination against the United States and its lessee seems apparent. The question, however, is whether it can be justified.").

The mere fact that military retirees and retired state and local government employees may "appear to be similarly situated" is not decisive. *Phillips Chemical Co.*, 361 U.S. at 381. Such an approach would deny respondents the opportunity to justify the differential tax treatment at issue. Even assuming there is a presumption favoring equal tax treatment of all government retirees, that presumption may be rebutted by demonstrating, as respondents have successfully done here, that there are significant differences which justify differential tax treatment of the two classes of taxpayers.

Davis also indicates that a state income tax scheme which discriminates against federal retirees does not, for that reason alone, violate 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity. The only prohibition arising out of the literal language of 4 U.S.C. § 111 is that the tax may not discriminate "because of the source of pay or compensation." 4 U.S.C. § 111. Clearly, the statute erects no *per se* prohibition against discriminatory state tax treatment of federal retirees. If this were true, the initial finding of disparate treatment in *Davis* would have been sufficient to establish the invalidity of the tax and further inquiry as to any significant differences between the two classes of taxpayers would have been superfluous.

The two classes of taxpayers in *Davis* were essentially alike. Where there are no significant differences between two classes of taxpayers, a discriminatory tax can only be seen to differentiate on account of some extrinsic factor such as the source of income. It was for this reason that the Michigan tax scheme was declared unconstitutional. However, a discriminatory tax can be justified if it is based on intrinsic differences "between the two classes themselves." *Davis*, U.S. at 816. Nothing in 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity prohibits

differential tax treatment of two classes of taxpayers that are inherently different.

Since the only type of discriminatory tax treatment prohibited by 4 U.S.C. § 111 is that based on the federal source of pay or compensation, it follows by implication that the statute does not prohibit discrimination based on any other grounds. While it is true that all federal retirees, including military retirees, are entitled to the protection of § 111, it does not follow that all federal retirees are alike and must be taxed in the same manner. Had Congress intended such a result the statute would contain words to that effect. Further, uniform taxation of federal retirees would seem inappropriate in light of petitioners' acknowledgement that "military retirement benefits are unique in comparison to other federal retirement benefits." (Pet. App. 29a).

The taxation of military retired pay under the KITA satisfies the test set out in *Davis* and is therefore valid. When the Court's rationale in *Davis* is applied to the facts of this case, it becomes clear that the KITA does not discriminate against military retirees based on the source of their retirement pay. The facts in *Davis* are distinguishable from those in the present case and the holding in *Davis* does not control the result here.

B. The taxation of military retired pay under the Kansas Income Tax Act is consistent with constitutional and statutory principles of intergovernmental tax immunity.

Davis is rightfully of major significance to a determination of the question presented in this case. However, *Davis* was not decided in a vacuum. It would be myopic to ignore the evolution of the doctrine of intergovernmental tax immunity and the legislative purpose in enacting 4 U.S.C. § 111 as they relate to the taxation of military retired pay under the KITA. Just as the Kansas tax treatment of

military retirees is valid under the test set out in *Davis*, it is likewise consistent with the purposes of constitutional and statutory tax immunity.

1. The taxation of military retired pay under the Kansas Income Tax Act is not repugnant to the implied constitutional doctrine of federal tax immunity.

The seminal case in the field of intergovernmental tax immunity is *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819). Incredibly, petitioners fail to discuss, or even cite, *McCulloch*. In *McCulloch*, a state statute prohibited the circulation of bank notes by the Bank of the United States except upon payment of a two percent stamp tax or annual fee of $15,000. Writing for a unanimous Court, Chief Justice John Marshall stated that the incorporation and operation of a bank was necessary to carry into effect certain powers expressly delegated to Congress. 17 U.S. at 406-424. The federal supremacy embodied in the Constitution was held to prohibit a state tax imposed directly on the operations of the Federal Government. There was a "total failure of (the State's) original right to tax the means employed by the government of the Union, for the execution of its powers." 17 U.S. at 430.

Chief Justice Marshall supplemented the immunity doctrine with his opinion in *Weston v. City Council of Charleston*, 27 U.S. (2 Pet.) 449 (1829), where a local tax on federal bond interest was declared invalid. The tax was held to be a burden on the contract between the Federal Government and the bondholder and, consequently, a burden on the power of Congress to borrow money on the credit of the United States. 27 U.S. at 469.

Together *McCulloch* and *Weston* established a rule of absolute federal tax immunity. A state tax imposing either a legal or economic burden on the operations of the Federal Government was deemed to be offensive to the federal

supremacy implicit in the Constitution. This broad rule remained intact for over 100 years and served, to some extent, as a model for the related doctrine of state immunity from federal taxation.[28] For example, in *Dobbins v. Commissioners of Erie County*, 41 U.S. (16 Pet.) 435 (1842), a state income tax on the salary received by an officer of the United States was held unconstitutional. Although it was a personal charge on the individual rather than on the Federal Government, the tax was found to interfere with the means devised to carry into effect the powers delegated to Congress and "present[ed] a case of as strong interference as was presented by the tax imposed by Maryland in [*McCulloch*] and the tax by the city council of Charleston in [*Weston*]." 41 U.S. at 449. Subsequently, in *Buffington v. Day*, 78 U.S. (11 Wall.) 113 (1871), a federal income tax on the salary of a state probate judge was declared unconstitutional.[29]

In the 20th century, the expansive interpretation of the doctrine of intergovernmental tax immunity was stead-

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[28] The sources of federal and state tax immunity are different, the former being grounded in the Supremacy Clause and the latter in principles of federalism and a concern for state sovereignty. Federal tax immunity has always been regarded as the more extensive of the two doctrines. *South Carolina v. Baker*, 485 U.S. 505, 518 n.11 (1988). Yet they are often spoken of as being reciprocal and complementary in nature. "[A]s the means and instrumentalities employed by the general government to carry into operation the powers granted to it are exempt from taxation by the states, so are those of the states exempt from taxation by the general government." *Willcuts v. Bunn*, 282 U.S. 216, 225 (1931), quoting *Ambrosini v. United States*, 187 U.S. 1, 7 (1902).

[29] "[T]he exemption of the officer from taxation by the general government stand upon as solid a ground and are maintained by principles and reasons as cogent as those which led to the exemption of the Federal Officer in *Dobbins v. Erie Co. supra*, from taxation by the states." *Buffington v. Day*, 78 U.S. at 127.

ily eroded.[30] The pivotal case, *James v. Dravo Contracting Co.*, 302 U.S. 134 (1937), upheld a state gross receipts tax on contractors performing services for the Federal Government. The Court stated that a tax imposed on the earnings of an independent contractor was distinct from a tax on a federal instrumentality and was not invalid simply because it resulted in increased costs to the United States. 302 U.S. at 157-160. "[I]t at most gives rise to a burden which is consequential and remote and is not one that is necessary, immediate and direct." *Id.* at 160, quoting *Trinityfarm Constr. Co. v. Grosjean*, 291 U.S. 466 (1934).[31]

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[30] *See e.g., Metcalf v. Mitchell*, 269 U.S. 514, 523-524 (1926) (upheld federal income tax on proceeds derived from contracts with state government) (the limitation on the taxing power of either government, in so far as it affects the other, "must receive a practical construction which permits both to function with a minimum of interference each with the other; and that limitation cannot be so varied or extended as seriously to impair either the taxing power of the government imposing the tax (citations omitted) or the appropriate exercise of the functions of the government affected by it."); *Willcuts v. Bunn*, 282 U.S. 216, 225 (1931) (rejected argument that federal income tax on gain from sale of municipal bonds imposed unconstitutional burden on borrowing power of the State) ("[t]he power to tax is no less essential than the power to borrow money, and in preserving the latter, it is not necessary to cripple the former by extending the constitutional exemption from taxation to those subjects which fall within the general application of nondiscriminatory laws, and where no direct burden is laid upon the governmental instrumentality and there is only a remote, if any, influence on the exercise of the functions of government.").

[31] That federal tax immunity was no longer based on the economic burden of a state tax on a federal function was assured in *Alabama v. King & Boozer*, 314 U.S. 1 (1941) (upheld imposition of state sales tax on purchases made by a "cost-plus" federal contractor whereby the full economic burden of the tax was borne by the Federal Government).

Dobbins and *Day* treated the salaries of government employees as immune from taxation on the theory that such a tax burdened the means selected to perform the functions of government. This rationale was rejected and these cases overruled in *Helvering v. Gerhardt*, 304 U.S. 405 (1938), and *Graves v. New York ex rel. O'Keefe*, 306 U.S. 466 (1939). *Helvering* upheld the imposition of federal income tax on salaries received by state employees. The reasoning of *Helvering* was found to be "of equal force" in *Graves*, 306 U.S. at 486, where the Court upheld a state income tax on the salaries of federal employees. Several fundamental principles emerge from *Helvering* and *Graves* regarding the constitutional doctrine of intergovernmental tax immunity as it applies to the taxation of salaries paid to government officers and employees. Application of these principles to the facts of this case supports the conclusion that the taxation of military retired pay under the KITA is constitutional.

a. The taxation of military retired pay under the Kansas Income Tax Act does not unduly interfere with the operations of the Federal Government.

The rationale upon which the constitutional doctrine of intergovernmental tax immunity is based was stated in *Graves*:

> The theory of the tax immunity of either government, state or national, and its instrumentalities, from taxation by the other, has been rested upon an implied limitation on the taxing power of each, such as to forestall undue interference, through the exercise of that power, with the governmental operations of the other. 306 U.S. at 477-478.

That the immunity doctrine exists to protect governments, not government employees, is beyond dispute.

"[A]s applied to the taxation of salaries of employees of one government, the purpose of the immunity was not to confer benefits on the employees * * * but to prevent undue interference with the one government by imposing on it the tax burdens of the other." *Id.* at 483-484.

Here, neither the petitioners nor the United States as *amicus curiae* have alleged that the taxation of military retired pay unduly interferes with the operations of the Federal Government. Petitioners give this issue only cursory attention and speculate, without demonstrating, that the Kansas income tax scheme "carries the potential to frustrate the objectives of Congress." (Pet. Br. 41). Such guesswork falls woefully short of the requisite standard. "When immunity is claimed from a tax laid on private persons, *it must clearly appear that the burden upon the* (government) *function is actual and substantial, not conjectural.*" *Helvering,* 304 U.S. at 421 (emphasis added).

Of even greater significance is the statement of interest of the United States contained in the *amicus* brief filed by the Solicitor General. There it is stated that the United States "has a substantial interest in ensuring that those to whom it pays pension benefits receive fair and equitable tax treatment from the States." (U.S. Br. 1). Nowhere does the United States assert that the KITA interferes with the exercise of powers delegated to Congress, with respect to the regulation of the armed forces or otherwise. Contrary to *Graves,* the United States apparently believes that federal tax immunity is designed to protect federal employees, whereas its true purpose is to protect the Federal Government. The inability of the United States to articulate any actual interference with its governmental functions confirms the lack of any colorable basis to support a claim that the KITA offends the Constitution.

Here, as in *Helvering* and *Graves,* the tax is imposed on private individuals and is paid from private funds. "The

theory, which once won a qualified approval, that a tax on income is legally or economically a tax on its source, is no longer tenable." *Graves*, 306 U.S. at 480. To the extent that such a tax results in an indirect economic burden on the government, "that burden is but a necessary incident to the co-existence within the same organized government of two taxing sovereigns and is one which the Constitution presupposes." *Helvering*, 304 U.S. at 424.

The taxation of military retired pay does not impose either a legal or economic burden on the United States nor has it been demonstrated to result in any substantial interference with the operations of the Federal Government. For these reasons, the KITA does not run afoul of the constitutional doctrine of intergovernmental tax immunity.

b. As applied to the taxation of salaries paid to government employees, the constitutional doctrine of intergovernmental tax immunity should be narrowly construed.

The Constitution contains no express limitation on the power of a State to tax the Federal Government or its instrumentalities. The doctrine of federal immunity from state taxation was implied in *McCulloch* as a necessary consequence of the federal system of government. States, by the exercise of their taxing power, are not permitted to retard or impede the operations of the Federal Government. *McCulloch*, 17 U.S. at 436. But federal tax immunity is a zero-sum game. Any expansion of federal immunity results in a corresponding curtailment of the States' power to tax. The Court has therefore concluded that the implied immunity of one government from taxation by the other should, as a principle of constitutional construction, be narrowly restricted. *Graves*, 306 U.S. at 483. A narrow construction is particularly appropriate where, as here, the immunity is invoked by private citizens, for then the im-

munity tends to operate for their benefit at the expense of the taxing government and without corresponding benefit to the government in whose name the immunity is claimed. *Id.; Helvering,* 304 U.S. at 418.

It is conceivable that equalizing the tax treatment of military retirees and retired state and local government employees might somehow further the legitimate federal interest in maintaining an efficient and effective military force. Such treatment would also appear to comport with the Solicitor General's notions of "fair[ness] and equit[y]." But the Supremacy Clause does not confer individual rights and protections, its purpose is to allocate authority between the States and the Federal Government. Petitioners are therefore not relieved of their burden to demonstrate that the Kansas income tax scheme actually interferes with the operations of the Federal Government.

Because there has been no showing that the taxation of military retirees interferes with the operations of the Federal Government, prudential considerations of constitutional construction weigh against extending federal tax immunity to individual military retirees and thereby diminishing the power of the State of Kansas to tax its citizens.

c. There are structural safeguards in Kansas state government which adequately protect the interests of military retirees.

The famous maxim attributed to *McCulloch*—"the power to tax is the power to destroy"—was an expression of concern regarding the lack of adequate safeguards in the structure of state government to prevent abusive taxation of federal interests. *McCulloch,* 17 U.S. at 428. On one hand, a federal tax on a state instrumentality is based on the consent of the citizens of the several States, acting through their representatives in Congress, to a tax on them-

selves and their institutions. It is the act of the whole on one of its parts. The constituents' influence over their representatives is regarded as sufficient to guard against abusive exercise of the federal taxing power. On the other hand, when a State imposes a tax on a federal function, those affected by the tax are often unrepresented in the legislative process of determining whether and to what extent such a tax should be levied. It is the act of a part of the whole. Under these circumstances, there is no "political check" to protect the interests of those subject to the tax and prevent the State from wielding its taxing power with destructive force. *Id.* at 428-429; 435-436.

In this case, however, the individuals who are subject to the tax have full and adequate representation in the state political and legislative process. The members of the class of over 14,000 military retirees are all constituents of the State of Kansas. Together with other Kansans, many of whom are also retirees who pay Kansas income tax on their retirement benefits, they have elected those state legislators and executive officers whom they consider best qualified to serve their interests. In fact, the class of military retirees represented by petitioners includes a current member of the Kansas House of Representatives. In no sense are petitioners disenfranchised with respect to the Kansas statutory scheme here at issue.

The words of Chief Justice Marshall were an echo from an earlier day when the colonies rebelled against taxation without representation. Here, petitioners enjoy adequate representation in state government. There is no justification for invoking federal immunity to set aside a state income tax scheme put in place by the petitioners' duly elected representatives. To do so would amount to judicial overreaching inconsistent with the narrow construction to be applied when federal tax immunity is asserted by private individuals.

2. The taxation of military retired pay under the Kansas Income Tax Act does not violate 4 U.S.C. § 111.

a. The statutory immunity for salaries of federal officers and employees is coextensive with that provided by the constitutional doctrine of intergovernmental tax immunity.

In addition to the federal tax immunity that flows from the Constitution, Congress may, by legislation, grant or withhold immunity from state taxation. *Graves*, 306 U.S. at 478. Shortly after *Graves* was decided, Congress enacted 4 U.S.C. § 111 as part of the Public Salary Tax Act of 1939, ch. 54, § 4, 53 Stat. 575. Section 111 effectively codified the result in *Graves* and permitted States to tax the salaries of federal officers and employees. *Davis*, 489 U.S. at 812. Federal tax immunity was retained in the statute only to the extent necessary to prohibit discrimination against federal officers and employees "because of the source of their pay or compensation." 4 U.S.C. § 111.

Section 111 also "foreclosed the possibility that subsequent judicial reconsideration of *(Graves)* might reestablish the broader interpretation of the immunity doctrine." *Davis*, 489 U.S. at 812. Thus, the statute must be construed in a manner consistent with the constitutional jurisprudence of federal tax immunity existing at the time of its enactment. The immunity retained in 4 U.S.C. § 111 is no more extensive than the narrow scope of immunity discussed in *Graves* and does not provide federal officers and employees with protections not otherwise available to them.[32] Section 111 is not an independent and supplemental

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[32] *Compare* 4 U.S.C. § 111 with 31 U.S.C. § 742, a statutory immunity provision applicable to federal obliations, which was at issue in *Memphis Bank & Trust v. Garner*, 459 U.S. 392 (1983) (invalidated state bank tax applicable to interest on federal ob-

source of immunity from state taxation for private citizens; its scope is determined by reference to the constitutional doctrine. *Davis*, 489 U.S. at 814.

In enacting 4 U.S.C. § 111, Congress sought to prohibit discrimination by governments against governments, and insure a reciprocal right of taxation in both the States and the Federal Government with respect to the employees of the other. S. Rep. No. 112, 76th Cong., 1st Sess., at 9 (1939). The statute prohibits a state or local tax that "is aimed at, or threatens the efficient operation of, the Federal Government." *Id.* at 12. It does not proscribe discrimination *per se* against individual federal officers and employees.

There is nothing in the legislative history of 4 U.S.C. § 111 to support the conclusion that Congress intended to prohibit the Kansas tax scheme here at issue. The tax neither interferes with the operations of the Federal Government nor attempts to deny the right of the Federal Government to tax state employees or retirees. Given these facts, and inasmuch as 4 U.S.C. § 111 was intended to liberalize the States' ability to tax federal officers and employees, there are no statutory grounds on which to invalidate the Kansas tax treatment of military retired pay.

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ligations but not to interest on state obligations). In *Garner*, the Court stated that § 742 established a "broad exemption" for federal obligations from state and local taxation, which was in accord with "the long established congressional intent to prevent taxes which diminish in the slightest degree the market value of the obligations issued by the United States." 459 U.S. at 395-396, citing *Smith v. Davis*, 323 U.S. 111, 117 (1944). The contrast between the broad exemption from state taxation contained in § 742 and the narrow immunity reserved by § 111 illustrates that the scope of statutory immunity will differ in each instance depending on the degree to which Congress deems it necessary to protect the federal interest involved.

b. The taxation of military retired pay under the Kansas Income Tax Act does not discriminate against the Federal Government or those with whom it deals.

Both 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity contemplate that a State may tax those who deal with the Federal Government provided it does so in a nondiscriminatory fashion. A tax is nondiscriminatory if it is assessed on the interest of a private citizen in federal property "in common with other property of the same description throughout the state," *McCulloch*, 17 U.S. at 436; if it is imposed on salaries of government employees "derived from their employment in common occupations not shown to be different in their methods and duties than those of similar employees in private industry," *Helvering*, 304 U.S. at 420; and if the tax is also imposed on salaries paid for "like services by other employers, public or private," *Graves*, 306 U.S. at 483-484.[33]

The discussion *supra* at 11-18, regarding the significant differences between military retirees and retired state and local government employees demonstrates that the differential tax treatment of the two classes of taxpayers does not discriminate against the Federal Government or those with whom it deals. Military retired pay is current pay for current services whereas state and local government retirement benefits are deferred compensation for prior services. They are not "property of the same description."

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[33] Kansas is in accord with this interpretation of the immunity doctrine. *Clinton v. State Tax Commission*, 146 Kan. 407, 71 P.2d 857 (1937) (upheld Kansas income tax assessed on compensation paid to employee of federal instrumentality and rejected argument that such compensation was immune from tax). "[T]he tax in the instant case is in no sense discriminatory. It rests equally upon all whose work differs in no essential character from that performed by plaintiff." 146 Kan. at 424.

Further, military retirees have substantial duties and responsibilities to their employer while retired state and local government employees have none. There are significant differences in their "methods and duties" and their respective compensation is not paid "for like services."

United States v. Detroit, 355 U.S. 466 (1958), upheld a state tax imposed on lessees of federal property. Although the tax at issue applied only to lessees of tax-exempt property, including federal lessees, it sought to put lessees of exempt property on an equal footing with lessees of similar non-exempt property and was held to be nondiscriminatory. 355 U.S. 473-475. Although not central to the holding in *Detroit*, certain lessees of property owned by the State of Michigan were not subject to the tax imposed on other lessees of tax-exempt property, thus creating different tax treatment of certain state lessees compared to federal lessees. However, this did not cause the tax to be declared unconstitutional on the grounds that it discriminated against the Federal Government or its lessees. *Phillips Chemical Co.*, 361 U.S. at 385-386.

Similarly, in *United States v. Department of Revenue of Illinois*, 371 U.S. 21 (1962), the Court summarily affirmed a decision holding that a state sales tax applied to retailers on sales to the Federal Government but not on sales to charities, churches and schools was constitutional and did not discriminate against the Federal Government. These cases indicate that the imposition of a tax on those who deal with the Federal Government is not discriminatory although there are others who are not subject to the tax.

Phillips Chemical Co. v. Dumas Independent School Dist., 361 U.S. 376 (1960), struck down a state statutory scheme that imposed higher taxes on lessees of federal property than on lessees of similar state property. Petitioners' argument relies heavily on *Phillips*, but that case is distinguishable from the case at bar in several important respects.

The Court in *Phillips* stated that an inquiry into the validity of the state statutory scheme required "an examination of the whole tax structure of the state" to determine how "other taxpayers similarly situated are treated." 361 U.S. at 383, citing *Tradesmens Nat. Bank v. Oklahoma Tax Commission*, 309 U.S. 560, 568 (1940). Yet, while the Court specifically found no discrimination between federal lessees and lessees of private property, it failed to consider this fact in determining the validity of the tax. *Phillips*, 361 U.S. at 381. Instead, the Court confined its consideration to a comparison of the narrow class of lessees of tax-exempt public lands.

The Court rejected each of the three justifications offered in support of the validity of the tax. It is true here, as in *Phillips*, that differential tax treatment of those in privity with the Federal Government cannot be justified merely by a State's desire to further its own interests. 361 U.S. at 384. As acknowledged *supra* at 25, the validity of the KITA cannot be sustained upon a mere rational basis. In this sense the two cases are consistent. However, the Court's reasoning on the two other points, while appropriate in light of the particular facts in *Phillips*, is not applicable here.

In *Phillips*, the State of Texas received the rental income from state-owned leases and state statutes mandated the imposition of a lesser tax, or no tax at all, on state lessees. However, the taxing entity was the local school district, not the State. The school district could not offset its loss in tax revenues by increasing the rents on state lessees. Its only alternative was to make up the difference by increasing the tax on all other lessees. 361 U.S. at 384. Here, however, both the income tax exemption for Kansas state and local government retirement benefits and the amounts paid to state and local government retirees are

established under state law. Unlike the school district in *Phillips*, the State of Kansas can achieve the same after-tax result by either paying relatively low gross retirement benefits and providing that such benefits shall be exempt from Kansas income tax or by paying higher gross benefits and taxing them in the same manner as other non-exempt income. It is unimportant whether the State of Kansas elects to tax or exempt state and local government retirement benefits. A tax on such benefits would simply be "a washout," in the sense that the State does not derive any real tax revenue but simply recoups a portion of its up-front employment and labor costs. *Montana v. United States*, 440 U.S. 147, 170-171 (1979) (White, J., dissenting).

Because the State of Kansas is able to control both the amount of state and local government retirement benefits paid and the taxation *vel non* of such benefits, linking the taxation of military retirees to the taxation of retired state and local government employees is an inefficient, and likely ineffective, means of preventing discrimination against the Federal Government and those with whom it deals. The State could pay extraordinarily high gross benefits to its retirees but tax them at a prohibitive rate. Taxing military retirees at the same rate would be devastating yet, under petitioners' theory, this would be a legitimate nondiscriminatory means of taxation. The better approach, as illustrated by *Detroit*, is to require that those who deal with the Federal Government receive the same state tax treatment as their counterparts in the private sector.

Finally, in *Phillips* the Court found that the State of Texas and the Federal Government were engaged in "otherwise identical leasing activities," and the classification erected by the statutory scheme was unrelated to any actual differences between the two classes of taxpayers. 361 U.S. at 384-385. As discussed above, the activities of military retirees are not "otherwise identical" to those of state and

local government retirees. They are significantly different in many important respects. For these reasons, the rationale and result in *Phillips* are not controlling with respect to this case.

United States v. County of Fresno, 429 U.S. 452 (1977), upheld a county tax on possessory interests in tax-exempt property as applied to employees of the United States Forest Service living in homes owned by the Federal Government. The Court stated:

> The economic burden on a federal function of a state tax imposed on those who deal with the Federal Government does not render the tax unconstitutional so long as the tax is imposed equally on other similarly situated constituents of the State. 429 U.S. at 462.

Requiring equal taxation of other similarly situated taxpayers who are residents and voters of the State insures a "political check" against abuse of the State's taxing power at the expense of the Federal Government. *Id.* at 463.

In *Fresno*, there were no differences between those using state or federal property and the two classes received equal tax treatment. *Id.* at 464 n.13. Here, however, in light of the significant differences between them, military retirees and retired state and local government employees are not "similarly situated constituents" of the State of Kansas and *Fresno* does not require that they be taxed in the same manner. Instead, like the Forest Service employees in *Fresno*, whom the Court stated "are no worse off under California tax laws than those who work for private employers and rent houses in the private sector," military retirees are no worse off under the KITA than those who retire from employment in the private sector and receive private sector retirement benefits. *Id.* at 465. Under *Fresno*,

the KITA does not discriminate against military retirees. Military retired pay is taxed in the same manner as most other retirement pay which provides a sufficient "political check" to protect the Federal Government and its retirees from abusive state taxation.

Washington v. United States, 460 U.S. 536 (1983), involved a tax in some respects similar to the taxes at issue in *Detroit* and *Fresno*. The State of Washington routinely imposed a sales tax on purchasers of goods and services. However, on contracts for the Federal Government, state law placed the legal incidence of the tax on the contractor. Although the tax did not apply to non-federal contractors, the statute was upheld as nondiscriminatory. The parallels between *Washington* and case at bar are noteworthy.

In both cases there is a "political check" consisting of "a significant group of state citizens who can be counted upon to use their votes to keep the State from raising the tax excessively and thus placing an unfair burden on the Federal Government." *Washington*, 460 U.S. at 545. Just as the Washington sales tax was applied to federal contractors at the same rate as on transactions between private parties, so too is the Kansas income tax applied to military retired pay at the same rate as private sector retirement benefits. *Id.* Finally, neither Washington nor Kansas has "singled out" those who deal with the Federal Government for discriminatory treatment. *Id.* at 546.

The fundamental flaw in the arguments advanced by petitioners and their *amici* is that they seek to stretch 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity beyond the limits contemplated by Congress and the Constitution. Federal tax immunity restricts the States' sovereign taxing power only to the extent necessary to protect the operations of the Federal Government from undue interference. *Graves*, 306 U.S. at 483-484. However,

petitioners have seized upon this narrow immunity and attempt to use it as a sword, not a shield, to secure every available tax advantage. They are not content that military retirees are protected against being singled out and subjected to unusual and oppressive state tax burdens, which is the essence of discrimination.

If petitioners' inflated views on the subject of discrimination are accepted, the result will be a substantial and unwarranted infringement upon the State's sovereign power to tax its citizens and order its domestic affairs. Should it so desire, Congress can amend 4 U.S.C. § 111 and extend the immunity to achieve the result sought by petitioners. But until that time, the State's power to tax can be denied only under the "clearest constitutional mandate." *Washington*, 460 U.S. at 546, citing *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 293 (1976).

CONCLUSION

It is respectfully submitted that the judgment of the Supreme Court of the State of Kansas should be affirmed.

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October Term, 1991

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PETITIONERS,

VS.

STATE OF KANSAS, *ET AL.*,
RESPONDENTS.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF KANSAS

REPLY BRIEF ON THE MERITS

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REPLY TO STATEMENT OF THE CASE

It is true that creation of the Kansas Public Employees Retirement System ["KPERS"] in 1961 was also accompanied by income tax exemptions for KPERS benefits and federal civil service retirement benefits. [Respondents' Br. at 4 n.3]. However, the exemption for KPERS benefits was enacted to maximize the value of state retirement income while minimizing the need for higher benefit payments.

> '. . . When the state originally embarked upon its state retirement program an income tax exemption was granted to the participants on the basis that the actual retirement benefits plus the income tax exemption, when taken together, amounted to a

> justifiable composite retirement program. In making this decision the state rejected proposals for higher retirement benefits without exemption from income tax liability.'

Special Comm. on Assessment and Taxation, 2 *Report on Kansas Legislative Interim Studies to the 1978 Legislature* 376 (1977) [quoting message of Governor Bennett].

It is also true that military retirees have sought relief from disparate income taxation in Kansas since at least 1971; but they have been unable to obtain equal tax treatment through the legislative process. [Respondents' Br. at 5 n.3; *see also* R. at 1602-1616, *Barker* (Dist. Ct. Case No. 89-CV-666)]. Moreover, this legislative record and supporting history contains ***no evidence*** that "[t]he Kansas tax treatment at issue is the product of a considered determination premised on appreciable differences between military retirees and all other retirees" stemming from "the unique status of military retirees." [Respondents' Br. at 30].[1]

Finally, mandatory employee contributions to the KPERS system are "picked up" by their employer in accordance with Kan.Stat.Ann. § 74-4919(2)(a) (Supp. 1990). [Respondents' Br. at 6]. These contributions avoid federal income taxation when made since they are "treated as employer contributions" under 26 U.S.C. § 414(h)(2), § 401(a) and § 403(a). Therefore, despite Respondents' erroneous assertion to the contrary [Respondents' Br. at 6], 26 U.S.C. § 72(o) does not exclude from taxable income any mandatory employee contributions under KPERS or other

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[1] Respondents have notably failed to cite any statutory language or legislative history which suggests, directly or indirectly, that military status or burdens associated with military retirement have ever been considered or endorsed by the Kansas Legislature as any basis for disparate tax treatment of military retirees. As Respondents well know, such evidence does not exist.

government plans.[2]

ARGUMENT

Proper application of the modern doctrine of intergovernmental tax immunity in this case -- the heart of which is nondiscriminatory taxation -- requires objective examination of the Kansas income tax structure applicable to all retired government employees and the nature of the classification erected by Kan.Stat.Ann § 79-32,117 (Supp. 1990). However, Respondents' unpersuasive attempt to justify the Kansas tax scheme ignores its structure as a whole, its source-dependent classification, and its operative effect on all federal, state and local government retirees. Instead, Respondents selectively limit the

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[2] In relevant part, 26 U.S.C. § 72(o) provides:

> (1) **Treatment of contributions.** -- For purposes of this section and sections 402 and 403, notwithstanding section 414(h), any deductible employee contribution made to a qualified employer plan or government plan shall be treated as an amount contributed by the employer which is not includible in the gross income of the employee.
>
> * * * *
>
> (5) **Definitions and special rules.** -- for purposes of this subsection —
>
> (A) **Deductible employee contributions.** – The term 'deductible employee contributions' means any qualified voluntary employee contribution (as defined in section 219(e)(2)) made after December 31, 1981, in a taxable year beginning after such date and made for a taxable year beginning before January 1, 1987, and allowable as a deduction under section 219(a) for such taxable year.

Consequently, Section 72(o) is expressly limited to ***voluntary*** employee contributions made to "an individual retirement plan" [26 U.S.C. § 219(e)(2)], between January 1, 1982 and December 31, 1986, which qualifies for an IRA deduction under 26 U.S.C. § 219(1).

inquiry to asserted differences between federal military retirees and all government retirees who receive preferential tax treatment, and impermissibly erect an artificial classification -- unrelated to the actual tax structure at issue -- ostensibly designed to account for those asserted differences. While this result-oriented approach inherently skews the proper inquiry and does not weigh any federal sovereignty interests in the balance, it ultimately fails to identify any "significant" differences between even these retirees which furnish a genuine reason for differential treatment or justification for discrimination.

1. RESPONDENTS CANNOT JUSTIFIABLY LIMIT THE SCOPE OF INQUIRY.

Respondents endeavor to divert attention from the proper inquiry by criticizing Petitioners for showing that the unitary tax structure applicable to all government retirees in Kansas erects a classification which burdens every retired officer and employee of the United States who receives retirement compensation from any federal source other than the civil service retirement and disability fund. [*Cf.* Respondents' Br. at 20-22 *with* Petitioners' Br. at 4 n.4 and 15-29]. In this regard, it is claimed that Petitioners have made a "subtle shift" in position which transcends the pleadings, on behalf of taxpayers who are not before the Court, involving issues "not fairly embraced in the question presented." [Respondents' Br. at 20-22].[3] These distorted views are meritless and must not

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[3] Respondents' contention that the differential treatment of all federal retirees in Kansas should be ignored because the issue does not appear in the pleadings is not entitled to any credence. First, the petitions filed in the district court [J.A. 3-19, 27-32, 37-47] plainly comply with the liberal notice pleading requirements of Kan.Stat.Ann. § 60-208(a) (Supp. 1990). *See Oller v. Kincheloe's, Inc.*, 235 Kan. 440, 446, 681 P.2d 630 (1984) ["We now require only a bare-bones pleading which outlines the nature of the claim."]. There are no requirements to plead a cause of action, legal theories or matters of evidentiary proof to support a claim for relief. *Id.* at 446-449. Second, since this procedural objection was never raised in, nor passed upon by, the Kansas Supreme Court, [*see* Brief of Appellees, *Barker v. Kansas*, No. 90-65848 (Kan.Sup.Ct.); Pet. App. at 28a-29a], it is not before this Court on writ of certiorari. Finally,

be allowed to serve as red herrings.

Since Respondents concede, as they must, that "[t]he court should examine 'the whole tax structure of the state' in considering the validity of the Kansas income tax treatment of military retirees" [Respondents' Br. at 23 (citations omitted)], Petitioners cannot be faulted for doing so. Resolution of the question presented inherently requires a comprehensive examination of the tax structure applicable to all federal, state and local government retirees, *cf. Washington v. United States*, 460 U.S. 536, 542 (1983), and the analysis must "focus on the nature of the classification" created by Kan.Stat.Ann. § 79-32,117(c). *See Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U.S. 376, 383 (1960).[4] Petitioners have litigated these matters at length in the District Court of Shawnee County, the Kansas Supreme Court and this Court. [*See* R. at 505-577, *Barker* (Dist. Ct. Case No. 89-CV-666); Brief of Appellants at 10-14, 22-32, *Barker v. Kansas*, No. 90-65848 (Kan.Sup.Ct.); Reply Brief at 5-6, *Barker v. Kansas*, No. 90-65848 (Kan.Sup.Ct.); Pet. at 12-23, 28; Petitioners' Br. at 13-27, 29-30]. Nevertheless, Respondents persistently refuse to squarely address the differential taxation of all federal retirees who are burdened by the same source-dependent classification as retired members of the Armed Forces. [*See* Brief of Appellees at 22-23, *Barker v. Kansas*, No. 90-65858 (Kan.Sup.Ct.); Respondents' Br. in Opp. at 12-13; Respondents'

Respondents' procedural objection is predicated entirely upon the application of state law [i.e., Kan.Stat.Ann. § 60-208(a)] and, therefore, does not present a substantial federal question or otherwise affect the dispositive question on writ of certiorari.

[4] Since this method of inquiry is central to any objective evaluation of state tax statutes under the immunity doctrine [*see* Petitioners' Br. at 11-12, 16-20], the characteristics and treatment of all federal military and civilian retirees subject to Kansas income taxation is fairly embraced within the question presented. *See, e.g., Vance v. Terrazas*, 444 U.S. 252, 258-259 n.5 (1980); *Cuyler v. Sullivan*, 446 U.S. 335, 342-343 (1980); *Procunier v. Navarette*, 434 U.S. 555, 559-560 n.6 (1978).

Br. at 22-23].[5]

While the only parties before this Court are retired members of the Armed Forces [and their spouses, where

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[5] *Amici* National Conference of State Legislatures, et al. ["NCSL"], mistakenly argue that the disparate treatment of all federal retirees "was never litigated" and this matter should not be considered since "[o]ther federal retirement systems may or may not set up classes that significantly differ from the class of state and local government retirees." [*Amici* NCSL Br. at 13]. *Amici* is wrong on both counts. First, as previously demonstrated, this issue has been the subject of extensive briefing and all federal retirement systems have been brought to the attention of the courts below. Respondents have ignored the differential treatment of all federal retirees taxed by Kansas because it vividly demonstrates that discrimination is not based on any uniform differences between members of the favored and disfavored classes.

Second, the Court in *Phillips* properly focused on the nature of the classification established by Texas statute to determine whether state tax discrimination against federal lessees was "based on" and "justified by significant differences" between "*all* lessees of federal property" and all lessees of property owned by Texas and its political subdivisions. 361 U.S. at 383-385 [emphasis in original]. Although federal leasehold interests were expressly "subject to State or local taxation" at the time, 361 U.S. at 381 n.7, *Phillips* struck down the discriminatory tax statute because "the Texas classification" was unjustified. *Id.* at 387. Since the dispositive question in this case likewise involves the validity of a state tax statute, the focus must be on the nature of the Kansas classification which results in differential tax treatment of all government retirees within its reach.

In view of the fact that Kan.Stat.Ann. § 79-32,117(a) incorporates federal adjusted gross income as state law -- but not provisions of "[o]ther federal retirement systems," the Internal Revenue Code should be examined to determine whether Congress recognizes any "significant differences" between government retirees as the basis for tax discrimination. While Respondents also refuse to engage in this inquiry, all retired federal, state and local government employees who receive nondisability retirement income are subject to substantially the same tax burdens and benefits under federal law. [*See* Petitioners' Br. at 27-29, 35-36]. Indeed, it remains undisputed that for purposes of income taxation, *"members (or former members) of the Uniformed Services should be treated essentially the same as retirees under the civil service program and other qualified pension or annuity plans."* H.R. Rep. No. 1118, 89th Cong., 1st Sess. 4-5 (1965) [emphasis added].

applicable], this does not mean that the characteristics and treatment of other federal retirees are immaterial. The differential exemption scheme codified in Kan.Stat.Ann. § 79-32,117(c) creates two classes of government retirees identified strictly by source of retirement compensation: a favored class, the members of which receive benefits that are not taxed because the source of their compensation is specified as the basis for an exemption; and a disfavored class, the members of which receive benefits that are taxed because the source of their compensation is not specified as the basis for an exemption. In operation, this source-dependent classification scheme favors all state and local government retirees over all federal retirees (military and civilian) who receive nondisability benefits from any federal source except the civil service retirement and disability fund. Therefore, the Kansas tax structure itself defines the two classes which must be examined to determine whether differential taxation is based on and justified by significant differences between them. *See Phillips*, 361 U.S. at 380-385; *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 815-816 (1989).[6]

To be sure, no federal civilian retirees have asserted a claim for relief in this litigation. In this sense, their legal interests are not directly at issue. However, it is inconceivable that one can properly examine the "whole tax structure" of Kansas and "focus on the nature of the classification" without considering the characteristics and treatment of federal civilian retirees taxed under

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[6] Respondents' position that Petitioners' approach "might merit consideration if the class they represent included these other federal retirees" [Respondents' Br. at 22] erroneously suggests that the proper scope of inquiry is somehow dependent upon form over substance rather than the classification at issue. While Petitioners do not purport to champion or assert the legal interests of these other federal retirees, their consideration is appropriate because they have been placed in the same statutory class under Kan.Stat.Ann. § 79-32,117(a) and they are treated less favorably than state and local government retirees because of the differential exemption scheme created by Kan.Stat.Ann. § 79-32,117(c). Petitioners' certified class in this case, therefore, must not be confused with the class of favored retirees and disfavored retirees defined by the Kansas tax scheme, which must be the focus of any objective inquiry.

the same taxing provision as retired members of the Armed Forces.[7] If the characteristics of all similarly situated federal retirees in a disfavored class can be selectively ignored, it becomes considerably more difficult to accurately evaluate whether a state's proffered justification is the genuine reason for discrimination (if otherwise permissible) or an expedient afterthought crafted by taxing officials to mask unlawful state action.[8] Since the modern doctrine of intergovernmental tax immunity requires elevated scrutiny to account for the federal interests at stake, *Davis*, 489 U.S. 816, differential taxation cannot be upheld simply because "any state of facts reasonably may be conceived to justify it." *McGowan v. Maryland*, 366 U.S. 420, 426 (1961). Therefore, the characteristics and treatment of other federal retirees who are taxed by Kansas must be considered, ***as evidence*** in evaluating the nature of the statutory classification at issue *and* determining whether the classification is directly related to any significant differences between the favored and disfavored class of government retirees.

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[7] Respondents contend that the treatment of these federal retirees should not be "grouped together" with military retirees or otherwise considered "[b]ecause military retirees are unique and thus unlike other 'disfavored government retirees.'" [Respondents' Br. at 22]. However, all federal military and civilian retirees taxed under Kan.Stat.Ann. § 79-32,117(a) are already "grouped together" by statute; they share relevant characteristics for purposes of retirement and taxation [Petitioners' Br. at 13-14, 23, 36-39]; they receive substantially the same treatment under relevant provisions of the Internal Revenue Code which have been incorporated as Kansas law [Petitioners' Br. at 27-29, 35-36]; and they are adversely affected by the differential classification codified in Kan.Stat.Ann. § 79-32,117(c). Regardless of one's views on the ultimate standard of justification, these federal civilian retirees are "similarly situated" with military retirees under the Kansas tax scheme and they may not be excluded from consideration. *Cf. Phillips*, 361 U.S. at 381, 383.

[8] Although the property at issue in *Phillips* was an "ordnance works" leased from the United States and no other federal lessees were parties to the action, this Court utilized lessees of "[w]arehouse facilities" to demonstrate the absence of any direct relationship between the Texas classification and the asserted basis for tax discrimination. 361 U.S. at 384-385.

II. THE KANSAS TAX STRUCTURE DOES NOT RECOGNIZE ANY "SIGNIFICANT DIFFERENCES" BETWEEN GOVERNMENT RETIREES THAT DIRECTLY RELATE TO OR JUSTIFY INCONSISTENT TAX TREATMENT.

A. No Asserted Differences Between Government Retirees Who Receive Nondisability Benefits Are Significant For Purposes of Taxation.

Respondents contend that because military retirees face continuing burdens in retirement under federal law and receive retirement income which is current compensation for reduced service, they are "significantly different" from all other retirees. [Respondents' Br. at 11-18]. If the nondiscrimination clause of 4 U.S.C. § 111 is to have any meaning, however, military and civilian retirement systems may not be selectively compared to achieve a particular result, as Respondents and their *amici* have done. Instead, these retirement systems must be compared as a whole to determine whether any asserted differences have significance in light of the purpose for taxation or exemption and the doctrine of intergovernmental tax immunity. *Cf. Kuhn v. State of Colorado*, 817 P.2d 101, 108 (Colo. 1991) (*en banc*) [when taken as a whole, the military retirement system is akin to civilian retirement systems], *pet. for cert. pending* (U.S.) (No. 91-980).[9] Viewed in this manner, there are no significant differences between federal government retirees who are taxed in Kansas and the government retirees who are not which can be seized upon to justify discrimination here.

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[9] This need is particularly acute where, as here, the State has previously elected to treat military retired pay as pension income: to reduce its own employment costs by prohibiting military retirees from purchasing prior service credit under KPERS, *see* Kan.Stat.Ann. § 74-4919h(1) (Supp. 1990); to increase its tax base by prohibiting military retirees from taking an IRA deduction based on contributions made with military retired pay, Pet. App. at 24a-25a; and to provide for ex-spouses who reside in Kansas upon divorce by treating military retired pay as marital property, Kan.Stat.Ann. § 23-201(b) (1988).

In relevant part, the state and military retirement systems are designed to allow participants to "**retire from active service without prejudice**" and to promote "economy and efficiency in the administration of government affairs." *Cf.* Kan.Stat.Ann. § 74-4901 and § 74-4951 (1985) [emphasis added] *with McCarty v. McCarty*, 453 U.S. 210 (1981).[10] Like KPERS and the federal civil service retirement system, the retirement system for members of the Uniformed Services (which includes the Armed Forces) is a "government plan" under the Internal Revenue Code. *See, e.g.*, Rep. No. 938, 94th Cong., 1st Sess. 450 (1976), *reprinted in* 1976 U.S. CODE CONG. & ADMIN. NEWS 3439 at 3877; H. Conf. Rep. No. 1515, 94th Cong., 2d Sess. 408 (1976), *reprinted in* 1976 U.S. CODE CONG. & ADMIN. NEWS 4212. Members of the Armed Forces may retire only after satisfying the statutory requirements for eligibility, which generally require at least 20 years of qualifying active service. *Mansell v. Mansell*, 490 U.S. 581, 583 (1989).[11] Upon retirement, military retirees leave active government service and lose all entitlement to active service pay and allowances. *See* 37 U.S.C. § 204(a), § 402(a), § 403(a) (1988). Retired members of the Armed Forces are "*retired*" and they are entitled to receive "retired pay" under applicable provisions of Title 10 and 14 of the United States Code. *See,*

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10 In *McCarty*, this Court recognized that the major goals of the "military retirement system" are "to provide for the retired service member, and to meet the personnel management needs of the active military forces." 453 U.S. at 232-233.

11 Federal civilian employees must likewise comply with statutory requirements to qualify for retirement and retirement benefits. *See Zucker v. United States*, 758 F.2d 637, 640 (Fed.Cir.) [entitlement to federal civil service retirement benefits are a matter of "legal status" which "must be determined by reference to the statute and regulations governing these benefits, rather than to ordinary contract principles." (*citing United States v. Larionoff*, 431 U.S. 864, 869 (1977)], *cert. denied*, 474 U.S. 842 (1985).

e.g., *McCarty v. McCarty*, 453 U.S. at 214.[12] Like other forms of federal and state retirement income, military retired pay is calculated based on years of qualifying past service and rank. *See McCarty*, 453 U.S. at 214.

In view of these shared attributes which make the military and civilian retirement systems comparable for present purposes, it is significant, yet undenied, that military retirees who receive nondisability retired pay are treated in substantially the same manner under relevant provisions of federal tax law as all other federal, state and local government retirees who receive nondisability retirement compensation. [Petitioners' Br. at 27-29, 35-36]. This equality of treatment under applicable federal laws of income, employment, estate and gift taxation reflects a considered determination by Congress that **"there is no substantial grounds for distinguishing the tax treatment of the [retirement] plan for the uniformed services from these other [qualified pension or annuity] plans."** *Cf.* H.R. Rep. No. 1118, 89th Cong. 1st Sess. 4 (1965) [emphasis added]. Since Congress,

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12 In the recent case of *Sizemore v. Rinehart*, ___ So.2d ___ (Ala. Civ. App., Feb. 7, 1992) (No. CV-89-704-M), the Alabama Court of Appeals persuasively concluded:

> **Those statutes which set up the scheme for retirement of persons in the military services all indicate that those persons are 'retired' in the same sense as non-military retirees.** *See* 10 U.S.C.A. § 3911 (West 1959 and Supp. 1991); 10 U.S.C.A. § 684(b) (West 1983); 10 U.S.C.A. § 688 (West 1983); 10 U.S.C.A. § 1447-1455 (West 1983). **We cannot accept the commissioner's argument that because military personnel are subject to recall at any time, they are not 'retired' just like a state government retiree.** Consequently, the trial court was correct in holding that the Alabama taxation scheme which favored retired state employees over retired military employees violated the doctrine of intergovernmental tax immunity and 4 U.S.C.A. § 111 (West 1985).

Slip op. at 9 [emphasis added].

itself, has plainly concluded that there are no "significant" differences between military and other government retirees for purposes of taxation, it is not within the legitimate prerogative of any State to override that determination in an effort to justify discriminatory taxation.

B. Differential Treatment Is Not "Directly Related" To Any Asserted Difference Between Federal, State and Local Government Retirees.

Respondents contend that the first prong of *Davis* and *Phillips* is satisfied in this case because "an evenhanded application of the rationale for taxing military retirees does not result in the taxation of any state and local government retirees." [Respondents' Br. at 20]. This view is predicated on an erroneous reading of *Davis* and *Phillips* which must be rejected, and it emasculates any protection for federal interests under 4 U.S.C. § 111 by permitting statutory classifications which are both underinclusive and overinclusive.[13]

The first prong of the *Davis* and *Phillips* test plainly requires that differential taxation must be "based on" and "truly intended to account for" asserted differences between the two classes of affected taxpayers. *See Phillips*, 361 U.S. at 384; *Davis*, 489 U.S. at 817. Because the proffered justification must furnish the actual reason for discrimination -- in order to protect the federal interests which weigh in the balance -- the classification drawn by statute may not be overinclusive or underinclusive. *See*

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13 While other federal retirees are equally affected by the same statutory classification, Respondents have improperly and artificially singled out military retirees for comparison in an attempt to sustain disparate treatment. This selective approach is necessary because Respondents recognize that its proferred rationale for discrimination is not applicable to all members of the disfavored class of federal retirees who are taxed in Kansas. The fact that Respondents have not offered any rationale for taxing these federal civilian employees is telling.

Davis, 489 U.S. at 816-817; *Phillips*, 361 U.S. at 383-385.[14] *See also Amici* NCSL Br. at 8-9 n.2 [quoting *Billings v. Illinois*, 188 U.S. 97, 104 (1903)]. The fact that Kan.Stat.Ann. § 74,32,117(c) utilizes source of compensation to exempt federal retirees who are subject to certain post-retirement restrictions and recall to active service, ***and*** to tax federal retirees who are not, clearly demonstrates that Respondents' proffered justification for differential treatment is not the genuine basis for discrimination.

III. REVERSAL OF THE JUDGMENT BELOW DOES NOT REQUIRE ANY EXPANSION OF THE TAX IMMUNITY DOCTRINE.

Despite erroneous assertions to the contrary [*see, i.e.*, Respondents' Br. at 33-50], Petitioners do not seek to expand the constitutional or statutory doctrine of intergovernmental tax immunity or encroach upon state sovereignty interests. Simple application of the modern doctrine currently in existence -- the heart of which is the principle of "nondiscrimination" against the United States or those with whom it deals -- merits reversal of the judgment below. "[I]t still remains true, as it has from the time of *M'Culloch v. Maryland*, 4 Wheat 316 [1819], that a state may not discriminate against the Government or those with whom it deals." *Phillips* , 361 U.S. at 387. *See also Davis*, 489 U.S. at 812-814; *cf. South Carolina v. Baker*, 485 U.S. 505, 526 n.15 (1988) ["The nondiscrimination principle at the heart of the modern intergovernmental tax immunity case law . . . recognizes that the best safeguard against excessive taxation (and the most judicially manageable) is the requirement that the government tax in a nondiscriminatory fashion."].

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14 While the mode of "rational basis" analysis developed in Fourteenth Amendment cases is not controlling here, *Davis*, 489 U.S. at 816, it has been persuasively stated that a **"classification's underinclusiveness or overinclusiveness clearly demonstrates that its actual basis is something other than that asserted by the State."** *Dandridge v. Williams*, 397 U.S. 471, 508 (1970) (Marshall, J., dissenting, joined by Brennan, J.) [emphasis added].

Likewise, proper application of the modern doctrine does not turn upon whether state taxes "interfere with the Federal Government's ability to perform its governmental functions." *Davis*, 489 U.S. at 814; *Phillips*, 361 U.S. at 383-385. Instead, the appropriate test is whether the tax discriminates against the United States or those with whom it deals. *Id.*; *see also South Carolina v. Baker*, 485 U.S. at 523 ["under current intergovernmental tax immunity doctrine the States . . . can tax private parties, even though the financial burden falls on the United States, as long as the tax does not discriminate against the United States or those with whom it deals."]. For more than 50 years, congressional consent under 4 U.S.C. § 111 has been "expressly confined" to state and local "taxation which does not discriminate against [federal] officers or employees because of the source of their compensation." S.Rep. 112, 76th Cong., 1st Sess. 12 (1939); H.R. Rep. 26, 76th Cong., 1st Sess. 5 (1939). *Cf. Memphis Bank & Trust Co. v. Gardner*, 459 U.S. 392, 397-399 (1983) [after observing that the nondiscrimination clause of 31 U.S.C. § 742 is treated as "principally a restatement of the constitutional rule" of intergovernmental tax immunity, the Court invalidated a Tennessee bank tax which discriminated "against federal obligations * * * * by including in the tax base income from federal obligations while excluding income from otherwise comparable state and local obligations."].

In reality, Respondents seek to rip the very heart from the modern tax immunity doctrine by arguing that differential taxation is permissible as long as "those who deal with the Federal Government receive the same state tax treatment as their counterparts in the private sector." [Respondents' Br. at 47]. This self-serving proposition was rejected by the Court in *Davis*, 489 U.S. 814-815 and n.4, and Respondents have offered no justification for requiring any less than that "the State treat those who deal with the Government as well as it treats those with whom it deals itself." *Phillips*, 361 U.S. at 381-382, 385. *See also Davis*, 489 U.S. 815 n.4; *cf. Washington v. United States*, 460 U.S. at 544-545.

Although Respondents assert that the State political process provides a check against discriminatory taxation of federal retirees, this contention was expressly rejected by the eight-member majority in *Davis*, 489 U.S. at 815 n.4. Moreover, this alleged safeguard is illusory in practice once a group of taxpayers have been singled out for differential treatment. *Cf. South Carolina v. Baker*, 485 U.S. at 526 n.15; *Minneapolis Star v. Minnesota Comm'r of Rev.*, 460 U.S. 575, 585 (1983) [when the state selects a taxpayer or group of taxpayers for differential taxation, "the political constraints that prevent a legislature from passing crippling taxes of general applicability are weakened, and the threat of burdensome taxes becomes acute."]. The discriminating exemption of state and local retirement benefits -- the purpose of which is to reduce the level of taxation otherwise necessary to furnish the same level of benefits -- cannot provide any realistic protection for federal interests. *See Davis*, 489 U.S. at 815 n.4. Since federal military retirees represent a distinct minority of the voting population in Kansas, it is not surprising that their efforts to secure equal tax treatment from the Kansas legislature have failed for more than 20 years.[15]

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15 While it is also true that federal civil service retirees comprise only a small percentage of Kansas voters, the State has a unique interest in exempting these benefits from tax since KPERS recognizes that some of its own employees (e.g., national guard technicians) are "contributing member[s] of the United States civil service retirement system." Kan.Stat.Ann. § 74-4902(14)(B) (1985). Despite Respondents' unsupported assertions to the contrary [Respondents' Br. at 24], however, federal or state employees who are contributing members of the United States civil service retirement system must pay federal and state income tax on employee contributions when they are made. *See Hogan v. United States*, 513 F.2d 170, 174 (6th Cir. 1975); *Shimota v. United States*, 21 Cl.Ct. 510, 514 (1990), *aff'd*, 943 F.2d 1312 (Fed.Cir. 1991).

CONCLUSION

For the reasons set forth in the Brief for Petitioners, the Brief for the United States as Amicus Curiae in Support of Petitioners, the Brief Amicus Curiae on Behalf of The Retired Officers Association in Support of Petitioners, and this Reply, the judgment of the Kansas Supreme Court should be reversed and this case should be remanded for further proceedings to address the remedial issues which remain.

Respectfully submitted,

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OCTOBER TERM, 1991

KEYTON E. BARKER AND PAULINE BARKER, ET AL.,
PETITIONERS

v.

STATE OF KANSAS, ET AL.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF KANSAS

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Whether 4 U.S.C. 111, which codifies the constitutional doctrine of intergovernmental tax immunity, permits the State of Kansas to tax the retirement benefits of federal military retirees even though it exempts from taxation benefits paid to retired state and local employees.

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In the Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-611

KEYTON E. BARKER AND PAULINE BARKER, ET AL., PETITIONERS

v.

STATE OF KANSAS, ET AL.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF KANSAS

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

INTEREST OF THE UNITED STATES

Petitioners are representatives of a class of about 14,000 residents of the State of Kansas who have retired from service in the United States Armed Forces. The State of Kansas currently requires petitioners to pay taxes on the pensions they receive for their former federal military service, although it exempts from taxation pensions paid to retired employees of the State of Kansas and its political subdivisions. The United States has a substantial interest in ensuring that those to whom it pays pensions receive fair and equitable tax treatment from the States. The United States accordingly participated in *Davis* v. *Michigan Dep't of the Treasury*, 489 U.S. 803 (1989), in which this Court held that principles of intergovernmental tax immunity and 4 U.S.C. 111 prohibit a

State from taxing the pensions of federal retirees while exempting from tax the pensions of its own retirees. The United States has a similar interest in this case involving pensions paid to retired members of the Nation's armed forces.

STATUTORY PROVISIONS INVOLVED

1. The text of 4 U.S.C. 111 is set forth in Appendix A, *infra*.

2. The text of Kan. Stat. Ann. § 79-32,117 (Supp. 1990) is set forth in Appendix B, *infra*.

STATEMENT

1. Pursuant to Kan. Stat. Ann. § 79-32,117 (Supp. 1990), a taxpayer's adjusted gross income for purposes of the Kansas income tax is generally identical to that taxpayer's federal adjusted gross income (defined in 26 U.S.C. 62), increased by the items set forth in Section 79-32,117(b) and decreased by the items set forth in Section 79-32,117(c).[1] Because federal adjusted gross income includes retirement benefits without regard to source, see 26 U.S.C. 61(a)(11), all state and federal retirement benefits would be subject to taxation under this scheme unless specifically excluded by Section 79-32,117(c).

Pursuant to Section 79-32,117(c)(ii), adjusted gross income for Kansas purposes does not include amounts that "are specifically exempt from Kansas income taxation under the laws of the state of Kansas." Because various provisions of Kansas statutes exempt retirement benefits paid by the State and its political subdivisions,[2] this pro-

[1] The statute also provides for certain minor modifications related to estates, trusts, and partnerships, as set forth in Section 79-32,117(d) and (e).

[2] See, e.g., Kan. Stat. Ann. §§ 12-5005(e) (Supp. 1990), 13-14a10, 14-10a10 (1982) (exempting benefits paid to retired police officers and fire fighters under municipal retirement plans); Kan. Stat. Ann. § 20-2618 (Supp. 1990) (exempting benefits paid under a retirement

vision exempts state and local retirement benefits from taxation.[3]

By contrast, the statute excludes from adjusted gross income only two types of specifically identified federal retirement benefits: "[a]mounts received as annuities under the federal civil service retirement system, from the civil service retirement and disability fund,"[4] Section 79-32,117(c)(vii), and "[a]mounts received by retired railroad employees as a supplemental annuity under the provisions of 45 U.S.C. 228b(a) and 228c(a)(1) *et seq.*," Section 79-32,117(c)(viii).[5] All other federal retirement benefits are subject to taxation;[6] the most common bene-

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system for state judges); Kan. Stat. Ann. § 72-1768a (1985) (exempting benefits paid under a retirement system for school employees); Kan. Stat. Ann. § 74-49,105 (1985) (exempting benefits paid under a retirement system for court reporters); Kan. Stat. Ann. § 74-4923(b) (Supp. 1990) (exempting retirement benefits paid under the Kansas Public Employees Retirement System and Kansas Police and Fireman's Retirement System); Kan. Stat. Ann. § 74-4978g (Supp. 1990) (exempting benefits formerly accrued under the highway patrol pension fund); Kan. Stat. Ann. § 79-32,117(c)(ix) (Supp. 1990) (exempting benefits paid to retired city employees).

[3] The opinion of the Kansas Supreme Court did not identify any type of retirement benefit paid by a Kansas governmental unit that would be subject to the Kansas income tax scheme. See Pet. App. 9a (stating that "benefits paid to * * * state * * * and local government retirees are exempt from Kansas income tax").

[4] The Civil Service Disability and Retirement Fund covers participants in the Civil Service Retirement System, 5 U.S.C. 8301 *et seq.*, and in the Federal Employees' Retirement System, 5 U.S.C. 8401 *et seq.*, which generally encompasses federal civilian employees hired after December 31, 1983. See S. Rep. No. 166, 99th Cong., 1st Sess. 38-39 (1985).

[5] The latter provision apparently refers to portions of the Railroad Retirement Act of 1974, formerly codified in those sections of the United States Code. The analogous currently effective provisions are codified at 45 U.S.C. 231 *et seq.*

[6] Federal military retirees 62 years of age or older are entitled to a $120 tax credit against Kansas income tax. Kan. Stat. Ann.

fits subject to taxation are the federal military retirement benefits involved in this case.[7]

2. The named petitioners are representatives of a class of approximately 14,000 Kansas residents who are retired members of the United States Armed Forces (and, where applicable, their joint taxpayer spouses), all of whom were subject to Kansas income taxation on their military retirement benefits between 1984 and 1989. In 1989, petitioners filed two class actions contending that the Kansas taxation scheme violates the constitutional doctrine of intergovernmental tax immunity and 4 U.S.C. 111 because it discriminates in favor of state retirement benefits. See Pet. App. 3a-5a. The state district court rejected their claims. Pet. App. 36a-46a. It ruled that because retired federal military personnel are subject to recall to active duty, pensions payable to them are the functional equivalent of compensation for current services. Because the Kansas scheme taxes compensation for current services, the court perceived no discrimination against federal military retirees. *Id.* at 41a-44a.

3. The Kansas Supreme Court affirmed. Pet. App. 1a-35a. Citing this Court's holding in *McCarty* v. *McCarty*,

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§ 79-32,111b (1989). But this only partially mitigates the State's taxation of federal military retirement benefits. First, because many military personnel may retire after 20 years of service regardless of age, see, *e.g.*, 10 U.S.C. 3911 (Army), 6323 (Navy and Marine Corps), 8911 (Air Force), many military retirees are not eligible for the credit. Second, under applicable Kansas tax rates, this small credit is unlikely to shield the entire amount of retirement pay from state taxation. See Kan. Stat. Ann. § 79-32,110 (1989) (setting forth tax rates for Kansas income tax).

[7] In addition to federal military retirees, the Kansas system imposes an income tax on sums paid to retired Justices and judges of the United States under 28 U.S.C. 371; retired bankruptcy judges and magistrates under 28 U.S.C. 377; retired Claims Court judges under 28 U.S.C. 178; Foreign Service retirees under the Foreign Service Retirement and Disability Fund, 22 U.S.C. 4041 *et seq.*, 4071 *et seq.*; National Oceanic and Atmospheric Administration retirees under 33 U.S.C. 853*o*; and Public Health Service retirees under 42 U.S.C. 212.

453 U.S. 210 (1981), that a military pension was not subject to division in a divorce proceeding, as well as other decisions noting the continuing benefits and burdens that former military service places on a military retiree, see Pet. App. 17a-24a, the state supreme court agreed with the trial court's conclusion that pension benefits received by federal military retirees effectively are "reduced current compensation for reduced current services." Pet. App. 30a. The court held that the differences between military retirement benefits and traditional pension plans are sufficient to justify the disparate treatment. *Ibid.*

SUMMARY OF ARGUMENT

The decision of the Kansas Supreme Court misinterprets and misapplies the constitutional doctrine of intergovernmental tax immunity, as codified in 4 U.S.C. 111 and explicated by this Court in *Davis* v. *Michigan Dep't of the Treasury*, 489 U.S. 803 (1989). That doctrine prohibits direct state taxation of the federal government and, of pertinence here, prohibits the States from imposing more burdensome taxation upon those who deal with the federal government than upon those who deal with the State. If the State's tax structure discriminates against those who deal with the federal, rather than state, government, the disparate treatment is unlawful unless the tax classification is directly related to and justified by significant differences between the two classes. See *Phillips Chemical Co.* v. *Dumas Independent School District*, 361 U.S. 376, 383 (1960). In this case, Kansas has discriminated against federal military retirees, and in favor of state government retirees, without any justification reflecting significant differences between the two classes.

Kansas taxes federal military retired pay while completely exempting the retirement benefits received by state and local employees. The substantive features of the military retirement system identified as distinct by the Kansas Supreme Court—such as the continuing applica-

bility of the Uniform Code of Military Justice to military retirees and the possibility of involuntary recall to service —do not justify Kansas's regime. The overall structure of the Kansas tax system makes clear that Kansas has singled out military retired pay for disparate treatment based on the source of the benefits, not on the features identified by the Kansas Supreme Court.

In any event, military retirement benefits are in most relevant respects much more like other retirement benefits than like current wage income. Moreover, Kansas treats military retired pay as current compensation when that treatment will increase the State's tax revenues, but not when such treatment has a contrary effect. Finally, the Kansas Supreme Court erred in asserting that the differing manner of funding military, as opposed to state, retirement benefits justifies the State's disparate tax treatment; a truly nondiscriminatory tax would operate by reference to the manner of funding, and not the federal source of retirement benefits. Accordingly, the rationale of this Court's decision in *Davis* is controlling here; the Kansas Supreme Court erred in concluding otherwise.

ARGUMENT

I. THE DOCTRINE OF INTERGOVERNMENTAL TAX IMMUNITY PROHIBITS THE STATES FROM GIVING LESS FAVORABLE TAX TREATMENT TO THOSE WHO DEAL WITH THE FEDERAL GOVERNMENT THAN IT GIVES TO THOSE WHO DEAL WITH THE STATE

In 4 U.S.C. 111,[8] Congress has generally consented to state taxation of federal employees, subject to the limitation that "the taxation does not discriminate against the * * * employee because of the source of the pay or compensation." As this Court observed in *Davis*, the nondiscrimination clause in Section 111 codifies the prohibi-

[8] Congress enacted 4 U.S.C. 111 as part of the Public Salary Tax Act of 1939, ch. 59, § 4, 53 Stat. 575.

tion against discriminatory taxation embodied in the modern constitutional doctrine of intergovernmental tax immunity. 489 U.S. at 812-813. The doctrine's origins trace back to *McCulloch* v. *Maryland*, 17 U.S. (4 Wheat.) 316 (1819). The Court grounded its holding (invalidating a state tax levied upon bank notes issued by a national bank) in the Supremacy Clause, U.S. Const. Art. VI, Cl. 2, explaining that "if the right of the States to tax the means employed by the general government be conceded, the declaration that the constitution, and the laws made in pursuance thereof, shall be the supreme law of the land, is empty and unmeaning declamation." 17 U.S. (4 Wheat.) at 433. The impropriety of such taxation, the Court explained, arose from the fact that "when a State taxes the operations of the government of the United States, it acts upon institutions created, not by their own constituents, but by people over whom they claim no control. It acts upon the measures of a government created by others as well as themselves, for the benefit of others in common with themselves." *Id.* at 435.

In its modern form,[9] the doctrine of intergovernmental tax immunity relies heavily on the principle of nondiscrimination to police the dangers identified by the *McCulloch* Court.[10] See, *e.g.*, *Graves* v. *New York ex rel. O'Keefe*, 306 U.S. 466, 485-487 (1939). By tying state taxation of those dealing with the United States to state taxation of those dealing with the State itself, the non-

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[9] Prior to the 1930s, the doctrine of intergovernmental tax immunity prohibited state taxation of those who contracted with the United States "whenever the effect of the tax was or might be to increase the cost to the Federal Government of performing its functions." *United States* v. *County of Fresno*, 429 U.S. 452, 460 (1977). For example, the Court applied the doctrine "to exempt the salaries of all officers of the United States from taxation by the states." *Dobbins* v. *Commisioners of Erie County*, 41 U.S. (16 Pet.) 434, 448 (1842).

[10] The doctrine of intergovernmental tax immunity also prohibits direct taxation of one sovereign by the other. *Davis*, 489 U.S. at 811.

discrimination principle addresses the structural concerns expressed in *McCulloch* by ensuring parity of treatment. "[T]he best safeguard against excessive taxation (and the most judicially manageable) is the requirement that the government tax in a nondiscriminatory fashion. For where a government imposes a nondiscriminatory tax, * * * the threat of destroying another government can be realized only if the taxing government is willing to impose taxes that will also destroy itself or its constituents." *South Carolina* v. *Baker*, 485 U.S. 505, 526 n.15 (1988); see also *Washington* v. *United States*, 460 U.S. 536, 546 (1983).

In applying this principle, the Court has strictly enforced a rule of equal treatment, rejecting the more deferential level of scrutiny typically applied to economic classifications under the Equal Protection Clause. See *Davis*, 489 U.S. at 816. When a State legislates concerning economic matters unrelated to the activities of the federal government, the "power to classify is * * * extremely broad, and [the State's] discretion is limited only by constitutional rights and by the doctrine that a classification may not be palpably arbitrary." *Phillips Chemical Co.* v. *Dumas Independent School District*, 361 U.S. 376, 385 (1960).[11] But when a State taxes those who deal with the federal government—requiring the government's interests to be "weighed in the balance"—the State must treat those taxpayers "as well as it treats those with whom it deals itself." *Ibid.*[12]

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[11] See *City of Cleburne* v. *Cleburne Living Center, Inc.*, 473 U.S. 432, 440 (1985) (citations omitted), with regard to the Equal Protection Clause of the Fourteenth Amendment:

> The general rule is that legislation is presumed to be valid and will be sustained if the classification drawn by the statute is rationally related to a legitimate state interest. When social or economic legislation is at issue, the Equal Protection Clause allows the States wide latitude, and the Constitution presumes that even improvident decisions will eventually be rectified by the democratic processes.

[12] As this Court has noted, "[t]he danger that a State is engaging in impermissible discrimination against the Federal Govern-

In analyzing whether a State unlawfully discriminates against those dealing with the federal government, it is first "necessary to determine how other taxpayers similarly situated are treated." *Phillips Chemical*, 361 U.S. at 383. This, in turn, "requires 'an examination of the whole tax structure of the state.'" *Ibid.* (quoting *Tradesmens Nat'l Bank* v. *Oklahoma Tax Comm'n*, 309 U.S. 560, 568 (1940)); accord, *Washington* v. *United States*, 460 U.S. at 542, 545. If taxpayers dealing with the United States bear a heavier burden than similarly situated taxpayers dealing with the State, the tax classification violates the Constitution unless it is "directly related to, and justified by, 'significant differences between the two classes.'" *Davis*, 489 U.S. at 816 (quoting *Phillips Chemical*, 361 U.S. at 383).

Of central relevance here, this Court in *Davis* invalidated Michigan's income tax to the extent that it taxed the benefits of federal retirees while exempting retirement benefits paid by the State. Because Michigan's tax structure facially discriminated against those who dealt with the federal government, the Court's analysis concentrated on the State's proffered justifications for the disparate treatment. The Court rejected the contention that the State could justify the disparity based on its interest in hiring and retaining state employees. Implicitly contrasting the requirements of Section 111 with equal protection analysis, the Court held that "[t]he State's interest in adopting the discriminatory tax, no matter how substantial, is simply irrelevant to an inquiry into the nature of the two classes receiving inconsistent treatment." 489 U.S. at 816. The Court also rejected the State's argument that more favorable tax treatment for state retirees was justified by the higher level of benefits typically paid to federal retirees, reasoning that "[a] tax exemption truly intended to account for differences in retirement benefits would not discriminate on the basis of the source of those benefits * * *; rather, it would

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ment is greatest when the State acts to benefit itself and those in privity with it." *Davis*, 489 U.S. at 815 n.4.

discriminate on the basis of the amount of benefits received by individual retirees." *Id.* at 817.[13] Because Kansas discriminates against federal military retirees by taxing their benefits while exempting those received by state and local government retirees, and because the State has proffered no coherent and consistent justification for the disparity, *Davis* controls this case.

II. KANSAS IMPOSES A HEAVIER TAX BURDEN ON FEDERAL MILITARY RETIREES THAN ON STATE PUBLIC EMPLOYMENT RETIREES DESPITE A LACK OF "SIGNIFICANT DIFFERENCES" BETWEEN THE TWO CLASSES OF RETIREES

The Kansas Supreme Court erred in holding that the State's facially discriminatory taxation of federal military retirement benefits is justified by significant differences between those benefits and the benefits received by state and local government retirees. As relevant here, military retired pay does not differ significantly from other forms of deferred compensation. Both military and civilian employees retire and receive retirement benefits only upon satisfying statutory requirements for eligibil-

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[13] Similarly, in *Phillips Chemical* the Court invalidated a state tax that placed a heavier tax burden on those who leased property from the federal government, rather than from the State and its political subdivisions. The Court was unpersuaded by the State's argument that, in view of the scale of federal leases, equally favorable tax treatment for such leases would have an adverse impact on local government. The Court found that "the classification * * * [was] not based on such factors"; rather, it was based on "the identity of the * * * lessor." 361 U.S. at 384-385. In addition, although the State asserted that it could make up in rents what it lost in lower taxes on leases of state, but not federal, public lands, the Court observed that a political subdivision (*e.g.*, a school board) could not make up in rents what it lost in taxes because of tax exemption given to the State's, as opposed to its own, lessees. *Id.* at 384. Hence, the State's proffered rationale did not explain the disparate taxation of lessees of state and local, as opposed to federal, lands.

ity.[14] Like their civilian counterparts, military retirees cease to receive their regular salary upon retirement, and become entitled only to retirement pay.[15] Finally, as with military retired pay, the retirement benefits received by state public employees are typically based upon years of service and highest average pay rank achieved.[16] Despite these similarities, the Kansas income tax applies to re-

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[14] Retirement from the uniformed services generally requires the member to accrue a specified length of service, typically no fewer than 20 years. See, *e.g.*, 10 U.S.C. 3911 *et seq.* (Army), 6321 *et seq.* (Navy and Marine Corps), 8911 *et seq.* (Air Force). Subject to limited exceptions, members of the Armed Services also face mandatory retirement at age 62 irrespective of their years of service. 10 U.S.C. 1251. Under Kansas law, the "normal retirement date" for members of the Kansas Public Employees Retirement System is either at age 65, age 60 with 35 years of credited service, or any age with 40 years of credited service. Kan. Stat. Ann. § 74-4914(1) (Supp. 1990); see also, *e.g.*, Section 74-4914c(1) (correctional security officers may retire at age 50 with three consecutive years of credited service prior to retirement, or upon accruing ten years of credited service and reaching age 50); Section 74-4957(1) (for police officers or fire fighters employed before July 1, 1989, normal retirement age is generally at age 55 with 20 years of credited service).

[15] Only service members on active duty or some other form of full-time duty are entitled to basic pay and associated benefits. 37 U.S.C. 204(a), 402(a), 403(a).

[16] The amount of retirement pay to which a military retiree is entitled ordinarily depends on the number of years of service. 10 U.S.C. 3991(a)(1) (Army), 6333(a) (Navy), 8991(a)(1) (Air Force). The general rule is that a retired member is entitled to a stated percentage of his or her level of pay at retirement, multiplied by the years of creditable service. 10 U.S.C. 1406, 1407, 1409. In general, an employee retiring at the normal retirement age under the Kansas Public Employee Retirement System receives a retirement benefit calculated as a percentage of the retiree's highest annual salary, multiplied by years of credited service. See Kan. Stat. Ann. § 74-4915(1) (Supp. 1990); see also, *e.g.*, Section 74-4958 (police officers and fire fighters retiring at normal retirement age receive a percentage of their final average salaries, multiplied by years of credited service).

tirement benefits paid to military retirees, but not those paid to state and local government retirees. Pet. App. 9a.

The principal basis relied upon by the Kansas Supreme Court to justify its disparate taxation scheme is the continuing effect federal law has on retired members of the Armed Forces. See Pet. App. 16a-24a. A retired service member remains a member of the Armed Forces,[17] continues to be subject to the Uniform Code of Military Justice,[18] as well as other restrictions on post-retirement activities,[19] and may be ordered into active duty.[20] See *McCarty* v. *McCarty*, 453 U.S. 210, 221-222 & n.14 (1981). And in a variety of contexts federal cases have treated continuing obligations that accompany the receipt

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[17] See *United States* v. *Tyler*, 105 U.S. 244 (1882); 10 U.S.C. 3075(a) ("The Regular Army is the component of the Army that consists of persons whose continuous service on active duty in both peace and war is contemplated by law, and of retired members of the Regular Army."), 8075(a) ("The Regular Air Force is the component of the Air Force that consists of persons whose continuous service on active duty in both peace and war is contemplated by law, and of retired members of the Regular Air Force.").

[18] See 10 U.S.C. 802(a)(4) (making "[r]etired members of a regular component of the armed forces who are entitled to pay" subject to the UCMJ).

[19] For example, a retired officer who takes a civilian position with the federal government may have his retired pay reduced under 5 U.S.C. 5532. In addition, for three years after retirement, a retired officer may not receive retired pay if he "is engaged * * * in selling, or contracting or negotiating to sell, supplies or war materials" to specified federal agencies. 37 U.S.C. 801(b). And a retired officer faces criminal sanctions if, within two years of his release from active service, he represents any person in making a sale through the military department in which he is retired, 18 U.S.C. 281(a), or acts as an attorney or agent in prosecuting any claim involving his department or any subject matter in which he was directly involved while on active duty, 18 U.S.C. 281(b).

[20] See, *e.g.*, 10 U.S.C. 688(a) (a retired member of the Armed Forces "may be ordered to active duty by the Secretary of the military department concerned at any time").

of military retired pay as legally significant.[21] But none of those cases considered the nature of those obligations in connection with intergovernmental tax immunity or the meaning of 4 U.S.C. 111.[22] For several reasons, the con-

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[21] See, *e.g.*, *United States* v. *Tyler*, 105 U.S. 244, 245 (1882) (retired officer technically remains "in the service" for purposes of statute authorizing specified percentage pay increase for "every five years' service"); *Cornetta* v. *United States*, 851 F.2d 1372, 1382-1383 (Fed. Cir. 1988) (potential liability for retired pay does not constitute prejudice for purposes of laches); *United States* v. *Tafoya*, 803 F.2d 140, 142 (5th Cir. 1986) (government may not offset military retired pay against debt owed by retiree); *Costello* v. *United States*, 587 F.2d 424, 427-428 (9th Cir. 1978) (no vested right in existing method of calculating retired pay), cert. denied, 442 U.S. 929 (1979); *Berkey* v. *United States*, 361 F.2d 983 (Ct. Cl. 1966) (addressing heir's claim to accumulated retired pay of veteran who died while in veteran's hospital); *Hooper* v. *United States*, 326 F.2d 982, 987-988 (Ct. Cl.) (upholding application of UCMJ to retired members), cert. denied, 377 U.S. 977 (1964); *Hostinsky* v. *United States*, 292 F.2d 508, 510 (Ct. Cl. 1961) (retired Navy officer subject to dual compensation statute); *Lemly* v. *United States*, 75 F. Supp. 248 (Ct. Cl. 1948) (considering claim for military retired pay under Naval Aviation Personnel Act of 1940); *In re Siverling*, 72 Bankr. 78, 78-79 (W.D. Mo. 1987) (military retired pay is not property of bankrupt estate).

[22] Several post-*Davis* decisions of state supreme courts have addressed the character of military retired pay in assessing claims brought under Section 111. The present case aside, those decisions have consistently treated military retired pay as analogous, for purposes of Section 111, to more traditional retirement benefits. See, *e.g.*, *Kuhn* v. *Colorado*, 817 P.2d 101, 108 (Colo. 1991) (en banc) ("While it is true that Congress may have intended some portion of military retirement benefits to be current compensation for responsibilities accrued after retirement, * * * the overall scheme of the retirement benefits is akin to a civilian pension earned by the service member for years of active service."), petition for cert. pending, No. 91-980; *Pledger* v. *Bosnick*, 306 Ark. 45, 58, 811 S.W.2d 286, 291-292 (1991) (for purposes of class certification in a Section 111 action, military retirement benefits are properly viewed as "deferred compensation or in the nature of a pension"), petition for cert. pending, No. 91-375; *Hackman* v. *Director of Revenue*, 771 S.W.2d 77, 80 (Mo. 1989) (en banc) (*Davis* applies to claim brought by federal military retiree; Section 111 "draws no

tinuing effects of military service do not justify the disparities in taxation imposed by the Kansas scheme.

A. Kansas Does Not Evenhandedly Exempt Retirement Benefits Based on any Rational Connection with the Retiree's Ongoing Obligations

Consideration of "the whole tax structure of the state," *Phillips Chemical*, 361 U.S. at 383, reveals that Kansas exempts *all* state retirement benefits, but only certain federal benefits, identified by their source and not by characteristics that are relevant to tax policy. The substantive features of the military retirement system upon which the Kansas Supreme Court relied—the post-retirement restrictions placed upon the conduct of military retirees and the possibility of recall to active duty service—do not explain or justify the State's discriminatory income tax. As in *Davis* and *Phillips Chemical*, this Court should reject the State's "proffered rationale" for its discriminatory tax system because "an evenhanded application of the rationale" would result in a system of taxation that is substantially different from the one presently in effect. *Davis*, 489 U.S. at 817; see *Phillips Chemical*, 361 U.S. at 384-385.

1. Membership in the Armed Forces: Before turning to the substantive features of the military retirement system cited by the Kansas Supreme Court, we submit that the court erred in relying, Pet. App. 16a-17a, on the military status of retired service members as justifying discriminatory taxation. The statutory denomination of retired service members as remaining part of the service in which they have retired may have consequences when federal law operates by reference to such a status. Cf. *United States* v. *Tyler*, 105 U.S. 244, 246 (1882) (retired officers under former military pay statutes are entitled to pay increase awarded based on years of "service"). To justify state taxation of individuals merely by ref-

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distinction between federal military personnel and civil service personnel"), cert. denied, 493 U.S. 1019 (1990).

erence to their military status, however, lacks any basis in legitimate objectives of tax policy, and would impermissibly disadvantage citizens because of their service to the Nation, cf. *Carrington* v. *Rash*, 380 U.S. 89, 95-97 (1965), and their status as federal officers, 4 U.S.C. 111. Obviously, a State could not justify imposition of a greater tax burden on active-duty servicemembers than on other wage earners based on their military status. The same principle applies no less to retirees. Indeed, if Kansas were authorized to discriminate in income taxation because of the mere status of a taxpayer, the State's authority to "elevate form over substance," *Washington* v. *United States*, 460 U.S. at 544, would render the protections of intergovernmental tax immunity illusory.

While there are assuredly substantive consequences attached to the status of a military retiree, the military retirement system's distinctive features must be evaluated on their own terms, and not by reference to a label that Congress has affixed to retired service members.[23] As we now show, the substantive features associated with military retired status do not justify Kansas's discriminatory tax scheme.

2. Post-retirement restrictions: The fact that retired members of the Armed Forces are subject to certain restrictions on post-employment activities (including the substantive rules found in the UCMJ) neither explains nor justifies the unfavorable tax treatment that Kansas visits upon federal military retirees. First, these restrictions do not constitute employment (*i.e.*, they do not amount to a rendering of services for which the government pays the retiree compensation), and, so long as they are observed, they have no effect on the retiree's entitle-

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[23] Indeed, federal statutes recognizing that a retired member remains part of the service from which the member retired distinguish on their face between "retired members" and those "whose continuous service on active duty in both peace and war is contemplated by law." 10 U.S.C. 3075(a) (Army), 8075(a) (Air Force).

ment to or level of retirement benefits.[24] Second, Kansas imposes many similar post-employment restrictions upon its own retirees,[25] but does not tax their retirement benefits. Third, Kansas exempts benefits for federal retirees under the Civil Service Retirement System, even though the federal retirees remain subject to significant post-employment federal restrictions on their activities.[26]

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[24] Military retired pay does not compensate the retiree for the restrictions on post-retirement conduct. Military retirement benefits are calculated according to the retiree's years of service and rank achieved, see, *e.g.*, 10 U.S.C. 1406, 1407, 1409, and retirees receiving various levels of benefits are subject to the same restrictions. Indeed, even retirees who engage in post-retirement federal employment that results in the reduction of their retired pay, 5 U.S.C. 5532, nevertheless remain subject to other post-retirement restrictions upon servicemembers.

[25] For example, if a state employee retiring after June 30, 1988, accepts employment with any employer within the Kansas Public Employee Retirement System for whom the retiree worked during the two years before retirement, and then earns more than a specified amount, the retiree forfeits his or her retirement benefits while so employed. Kan. Stat. Ann. § 74-4914(6) (Supp. 1990). In addition, if a retired member of the police and fire fighter's pension system works for more than 30 days during a calendar year for "the same state agency or the same police or fire department of any county, city, township or special district or the same sheriff's office of a county," the retiree forfeits retirement benefits for any month in which he or she occupies the position. Kan. Stat. Ann. §§ 74-4957(5), 74-4957a(4) (Supp. 1990). And if a state employee has participated in contracting with any person or business within the employee's last two years of public employment, the employee may not accept a job with that person or business for a year after the employee's public service terminates. Kan. Stat. Ann. § 46-233(a) (1986).

[26] Certain federal retirees forfeit their retirement benefits if they are convicted of enumerated offenses relating to national security, 5 U.S.C. 8312; if they flee the country to avoid being prosecuted for such offenses, 5 U.S.C. 8313; if they refuse to testify regarding their former federal service as it relates to various matters of national security, 5 U.S.C. 8314; or if they materially falsify any federal employment application relative to specified national security matters, 5 U.S.C. 8315. In addition, a retiree, as a former federal

Fourth, although a retired service member may face somewhat more extensive post-retirement restrictions than a typical state or federal retiree, because of the UCMJ's continuing applicability, that fact does not explain and would not, in any case, justify the discrimination here, since Kansas also taxes the retirement benefits of various federal retirees who are not subject to that or any similar Code.[27] Kansas has not classified retirees, for tax purposes, based on the existence *vel non* of restrictions on post-retirement conduct; rather, it has singled out federal retirees, including retired servicemembers, for disadvantageous tax treatment based on the source of their retirement benefits.

3. Potential recall to active duty: Contrary to the Kansas Supreme Court's reasoning, Pet. App. 30a, the disparate treatment of military retirement benefits under the State's tax structure cannot be explained by a distinction between benefits payable to retirees who are subject to continuing service obligations and benefits payable to

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employee, is sharply limited in the extent to which he or she may represent persons before a federal agency concerning matters in which the former employee participated while in government. 18 U.S.C. 207(a) and (b).

[27] As we have discussed, see pp. 3-4, *supra*, Kansas exempts federal retirement benefits only if they are received either from the Civil Service Retirement and Disability Fund or by a retired railroad employee. Section 79-32,117(c)(vii) and (viii). Hence, Kansas taxes benefits received by certain Central Intelligence Agency employees whose benefits are paid from the Central Intelligence Agency Retirement and Disability Fund, 50 U.S.C. 403 note (Title II). Pet. App. 29a. The UCMJ does not apply to such retirees. See 10 U.S.C. 802(a). Officers serving in the National Oceanic and Atmospheric Association or the Public Health Service are subject to the UCMJ only when they are "assigned to and serving with the armed forces," 10 U.S.C. 802(a)(8), which evidently contemplates active duty. Kansas, however, fully taxes benefits received by NOAA and PHS retirees. Pet. App. 29a. Kansas also taxes the benefits received by Foreign Service officers from the Foreign Service Retirement and Disability Fund, 22 U.S.C. 4042, 4071a(2), even though the UCMJ does not apply to Foreign Service retirees.

other retirees. For example, whereas Kansas exempts the retirement benefits of state court judges, Kan. Stat. Ann. § 20-2618 (Supp. 1990), it taxes the benefits paid to retired federal judges under 28 U.S.C. 371(a), even though a federal judge who retires under that Section is not required to provide any current services to receive retirement salary.[28] Kansas also taxes the benefits of other federal retirees who are not subject to post-retirement obligations such as potential mandatory recall into service.[29] Thus, contrary to the state supreme court's reasoning, the distinction between Kansas's complete exemption of state and local retirement benefits, and its selective exemption of federal retirement benefits, is not based on a coherent rationale related to the contingent obligation of potential recall to service; rather, certain federal retirement benefits are taxed because of their

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[28] Through a process termed "retirement from office by resignation on salary," 28 U.S.C. 376(a)(2)(A), a qualifying federal judge may retire completely from federal judicial service and receive a lifetime annuity equal to his or her salary at the time of retirement, 28 U.S.C. 371(a). That would be subject to taxation under the Kansas scheme.

[29] For example, Kansas taxes retirement benefits received by certain CIA retirees, see note 27, *supra*, even though Section 271 of the Central Intelligence Agency Retirement Act of 1964 for Certain Employees makes clear that the retirees may be recalled to service only with their consent. See 50 U.S.C. 403 note. In addition, although Claims Court judges retiring pursuant to 28 U.S.C. 178 may continue to collect their annuities even if they elect not to perform continuing duties, 28 U.S.C. 178(j)(4), Kansas taxes the benefits paid under Section 178 because they are paid from the Claims Court Judges Retirement Fund, 28 U.S.C. 178(*l*)(1). And while certain PHS retirees may receive retirement benefits without being subject to involuntary recall to active duty, 42 U.S.C. 211(g)(3), 212(c), Kansas taxes their retirement benefits. The same is so with respect to noncareer Foreign Service officers who are taxed on the retirement benefits they receive from the Foreign Service Retirement and Disability Fund, see note 27, *supra*, but who are not even eligible for recall, cf. 22 U.S.C. 3948.

source.[30] Section 111, on its face, prohibits such a system of taxation.[31]

B. Military Retired Pay Is Not Analogous to Compensation Received by Current State and Local Employees

Even if Kansas's taxation of retirement benefits were otherwise evenhandedly applied, the possibility that military retirees will be recalled to service would not justify

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[30] The source-based approach of Kansas's taxation of federal retired pay is well illustrated by the State's tax treatment of federal bankruptcy judges and magistrates. Those officers may elect to receive retirement benefits through the Judicial Officers' Retirement Fund, 28 U.S.C. 377(f) and (h), instead of participating in the Civil Service Retirement System and receiving benefits from the Civil Service Retirement and Disability Fund, 5 U.S.C. 8348. See 28 U.S.C. 377(f)(1); see also 5 U.S.C. 8334(a)(1), 8336(k). As noted, benefits paid from the latter fund are exempt from taxation under Section 79-32,117(c)(vii). No similar exemption is available for benefits received from the Judicial Officers' Retirement Fund, even though a bankruptcy judge or magistrate may continue to receive benefits under that system without any possibility of recall to service. See 28 U.S.C. 377(m)(1)(B) and (m)(2).

[31] The Kansas Supreme Court suggested that the treatment of other federal retirees under state law is irrelevant to this case, because "[t]he legal interests of other federal retirees are not at issue in this appeal." Pet. App. 29a. We disagree. Although other federal retirees are not parties to this case, this Court's precedents make it clear that the decision whether a state tax scheme discriminates "requires 'an examination of the whole tax structure of the state.'" *Phillips Chemical Co.*, 361 U.S. at 383 (quoting *Tradesmens Nat'l Bank* v. *Oklahoma Tax Comm'n*, 309 U.S. 560, 568 (1940)). The Kansas Supreme Court indicated that it would have found it relevant "[i]f another class of federal retirees had exactly the same characteristics as the class of military retirees and was taxed differently." Pet. App. 29a. That concession concerning the relevance of the tax structure of the State is too narrow. In determining whether Kansas taxes military retirees' pay because of the federal source of their pay, and not the continuing obligations associated with its receipt, it is also relevant that, as we have shown, the State also taxes other federal retirees who do *not* share the identified characteristics of federal military retirees.

the State's treating military retired pay, for tax purposes, as it treats pay for current services by state and local employees. As the Court's analysis in *McCarty* reflects, military retired pay is much more closely analogous to deferred, rather than current, compensation paid to state and local employees:

> The amount of retired pay a service member receives is calculated not on the basis of the continuing duties he actually performs, but on the basis of years served on active duty and the rank obtained prior to retirement. Furthermore, *should the service member actually be recalled to duty, he receives additional compensation according to the active duty pay scale,* and his rate of retired pay is also increased thereafter.

453 U.S. at 223 n.16 (emphasis added).[32] In other words, while the receipt of military retired pay carries with it the contingent obligation of recall to active service, reali-

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[32] The Court in *McCarty* did note that military retired pay differs in some respects from a typical pension. 453 U.S. at 221-222. But the Court did not rest its holding—that a State may not treat military retired pay as property of the marital estate upon dissolution of a marriage—on a view of such benefits as current, rather than deferred, compensation. *Id.* at 223. Moreover, Congress promptly passed a statute to remove the effect of *McCarty*, subjecting military retired pay to the general rule permitting the division of retirement benefits upon divorce. See Uniformed Services Former Spouses' Protection Act, 10 U.S.C. 1408(c)(1) (subject to certain limitations, States may treat disposable military retired pay as "property of the member and his spouse"); *Mansell* v. *Mansell*, 490 U.S. 581, 584-585, 587-588 (1989); S. Rep. No. 502, 97th Cong., 2d Sess. 10 (1982) (the "primary purpose" in enacting the USFSPA was to permit the States "to treat military pensions in the same manner as they treat other retirement benefits"). The USFSPA therefore reflects Congress's judgment that military retirement benefits are sufficiently analogous to deferred compensation to permit the States to treat such benefits as property earned during marriage. Cf. *McCarty*, 453 U.S. at 221 ("The community property division of military retired pay rests on the premise that that pay, like a typical pension, represents deferred compensation for services performed during the marriage.").

zation of that contingency results in compensation other than retired pay for any services that are *actually* rendered by the retiree. Thus, it is the compensation for active service by a military retiree, if and when recalled, and not the retired pay preceding or following such a recall, that is comparable to the pay that is received by state and local employees for current services and taxed in full by the State.

C. Federal and Kansas Tax Law Treat Military Retired Pay as Deferred Compensation for Certain Purposes

The rationale of the Kansas Supreme Court is undermined further by the treatment of federal retirement benefits as deferred compensation, not current compensation, under other provisions of federal and state tax law. For example, in federal tax law, the distinction between current and deferred compensation is crucial under 26 U.S.C. 219, which governs the deductibility of taxpayer contributions to an individual retirement account (IRA). Under Section 219(b), the IRA deduction is limited to the amount of the taxpayer's compensation for the tax year or $2000, whichever is less. Section 219(f)(1) clarifies that " 'compensation' does not include any amount received as a pension or annuity and does not include any amount received as deferred compensation." It is well settled that federal military retirement benefits are excluded from the term "compensation" for purposes of Section 219(f)(1). See M. Weinstein, *Mertens: The Law of Federal Income Taxation* § 25C.12, at 58 (1988) ("Retirement income, including federal, civil and military retirement income, is not compensation for purposes of making deductible contributions to an IRA." As the Kansas Supreme Court acknowledged in this case, Pet. App. 24a-25a, the Kansas tax scheme follows this treatment precisely, recognizing that there is no significant difference between military retirement pay and other types of retirement benefits.[33]

[33] Moreover, following the enactment of 10 U.S.C. 1408, which authorizes the States to treat military retired pay as property for

The Kansas Supreme Court attempted to justify this treatment by explaining that "this limited definition of 'compensation' applies to § 219 *only*." Pet. App. 25a. That may be, but this does not undermine the logical inference to be drawn from the definition in Section 219: Kansas treats military retired pay as current compensation when that characterization increases its tax revenues, but declines to do so when it would produce the contrary tax consequences. The State's failure to treat military retired pay consistently suggests that the State's articulated rationale is not in fact the basis for the disparate treatment, but only a cloak for discrimination against federally funded benefits. The State has singled out military retired pay for unfavorable tax treatment based not upon any coherent rationale related to the character of that pay as current compensation for reduced services, but upon the State's desire to maximize its tax revenues while exempting state and local employees from taxation of their retirement benefits.

D. Differences in Funding Methods Do Not Justify the Discrimination Between State Government Pensions and Military Retired Pay

The Kansas Supreme Court also suggested, Pet. App. 26a, that different tax treatment might be justified by the difference in funding methods: whereas military retired pay is funded out of general revenues, the state and local retirement system is funded through employer and employee contributions.[34] The court found this considera-

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purposes of marital division, Kansas enacted a statute that treats "the present value of any vested or unvested military retirement pay" as "marital property." Kan. Stat. Ann. § 23-201(b) (1988). The State's inclusion of the present value of the future stream of military retired pay among the property of the marital estate is inconsistent with the State's treatment of such pay as current compensation for purposes of income taxation. Cf. *McCarty*, 453 U.S. at 221.

[34] To the extent the court's suggestion relies on the federal practice of paying benefits out of general revenues rather than annual

tion significant because Kansas taxes a state or local government employee's contribution to the retirement system as income in the year in which the contribution is made. *Ibid.*; see Kan. Stat. Ann. §§ 74-4919(2), 79-32,117(b)(vi) (Supp. 1990). Because a part of the retirement benefits received by state and local retirees therefore reflects previously taxed contributions, the court indicated that Kansas's disparate treatment of military retired pay merely compensates for the unavailability of previously taxable employee contributions under the military retirement system. Pet. App. 26a.

This is unpersuasive. Kansas retirement benefits are funded not only through employee contributions, but also through government contributions, see, *e.g.*, Kan. Stat. Ann. § 74-4920b (Supp. 1990), and pension fund investments, see, *e.g.*, Kan. Stat. Ann. § 74-4921 (Supp. 1990). Thus, the state supreme court would justify the State's taxation of the *full* measure of military retired pay on the ground that *part* of the benefits received by state and local employees—the sum attributable to employee contributions—had previously been taxed. Pet. App. 26a.

This rationale is foreclosed by *Davis*, in which the State sought to justify its tax discrimination against federal retirees by arguing that their retirement benefits typically exceed those of state retirees. 489 U.S. at 816-817. The Court rejected that contention because "[a] tax exemption truly intended to account for differences in retirement benefits would not discriminate on the basis of the source of those benefits * * *; rather, it would discriminate on the basis of the amount of benefits received

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contributions, the suggestion is baseless; it is no concern of state tax policy where the federal government gets the money to pay retirement benefits. To the extent the suggestion relies on the federal practice of not requiring employee contributions, the distinction is unsupported by the facts, because Kansas law exempts *all* retirement benefits Kansas governmental authorities pay, even though a significant portion of those benefits is funded directly by the State. See, *e.g.*, Kan. Stat. Ann. § 74-4920b (Supp. 1990) (discussing employer contributions to the Kansas Public Employees Retirement System).

by individual retirees." *Id.* at 817. By the same token, a tax truly intended to account for prior taxation of retirement benefits would not discriminatorily exempt certain benefits based on their source; rather, it would apply to retirement benefits generally, but exempt benefits to the extent that they reflect previously taxed contributions.[35]

* * * * *

There is, in sum, no coherent or consistently applied rationale that can justify Kansas's facially discriminatory taxation of military retirement benefits. It follows that 4 U.S.C. 111, as interpreted by this Court in *Davis*, prohibits that taxation.

CONCLUSION

The judgment of the Kansas Supreme Court should be reversed.

Respectfully submitted.

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JANUARY 1992

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[35] Even if military retired pay were contributory, and the employee contributions were subject to taxation when made, not all of the benefits received by federal military retirees in Kansas would previously have been taxed by the State; a Kansas military retiree may well have performed part or all of his or her qualifying service elsewhere. This consideration further undermines the State's proffered funding rationale.

APPENDIX A

4 U.S.C. 111. Same; taxation affecting Federal employees; income tax

The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States, a territory or possession or political subdivision thereof, the government of the District of Columbia, or an agency or instrumentality of one or more of the foregoing, by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.

APPENDIX B

Kan. Stat. Ann. § 79-32,117 (Supp. 1990). Kansas adjusted gross income of an individual.

(a) The Kansas adjusted gross income of an individual means such individual's federal adjusted gross income for the taxable year, with the modifications specified in this section.

(b) There shall be added to federal adjusted gross income:

(i) Interest income less any related expenses directly incurred in the purchase of state or political subdivision obligations, to the extent that the same is not included in federal adjusted gross income, on obligations of any state or political subdivision thereof, but to the extent that interest income on obligations of this state or a political subdivision thereof issued prior to January 1, 1988, is specifically exempt from income tax under the laws of this state authorizing the issuance of such obligations, it shall be excluded from computation of Kansas adjusted gross income whether or not included in federal adjusted gross income. Interest income on obligations of this state or a political subdivision thereof issued after December 31, 1987, shall be excluded from computation of Kansas adjusted gross income whether or not included in federal adjusted gross income.

(ii) Taxes on or measured by income or fees or payments in lieu of income taxes imposed by this state or any other taxing jurisdiction to the extent deductible in determining federal adjusted gross income and not credited against federal income tax.

(iii) The federal net operating loss deduction.

(iv) Federal income tax refunds received by the taxpayer if the deduction of the taxes being

refunded resulted in a tax benefit for Kansas income tax purposes during a prior taxable year. Such refunds shall be included in income in the year actually received regardless of the method of accounting used by the taxpayer. For purposes hereof, a tax benefit shall be deemed to have resulted if the amount of the tax had been deducted in determining income subject to a Kansas income tax for a prior year regardless of the rate of taxation applied in such prior year to the Kansas taxable income, but only that portion of the refund shall be included as bears the same proportion to the total refund received as the federal taxes deducted in the year to which such refund is attributable bears to the total federal income taxes paid for such year. For purposes of the foregoing sentence, federal taxes shall be considered to have been deducted only to the extent such deduction does not reduce Kansas taxable income below zero.

(v) The amount of any depreciation deduction or business expense deduction claimed on the taxpayer's federal income tax return for any capital expenditure in making any building or facility accessible to the handicapped, for which expenditure the taxpayer claimed the credit allowed by K.S.A. 79-32,177, and amendments thereto.

(vi) Any amount of designated employee contributions picked up by an employer pursuant to K.S.A. 12-5005, 20-2603, 74-4919 and 74-4965, and amendment to such sections.

(c) There shall be subtracted from federal adjusted gross income:

(i) Interest or dividend income on obligations or securities of any authority, commission or instrumentality of the United States and its

possessions less any related expense directly incurred in the purchase of such obligations or securities, to the extent included in federal adjusted gross income but exempt from state income taxes under the laws of the United States.

(ii) Any amounts received which are included in federal adjusted gross income but which are specifically exempt from Kansas income taxation under the laws of the state of Kansas.

(iii) The portion of any gain or loss from the sale or other disposition of property having a higher adjusted basis for Kansas income tax purposes than for federal income tax purposes on the date such property was sold or disposed of in a transaction in which gain or loss was recognized for purposes of federal income tax that does not exceed such difference in basis, but if a gain is considered a long-term capital gain for federal income tax purposes, the modification shall be limited to that portion of such gain which is included in federal adjusted gross income.

(iv) The amount necessary to prevent the taxation under this act of any annuity or other amount of income or gain which was properly included in income or gain and was taxed under the laws of this state for a taxable year prior to the effective date of this act, as amended, to the taxpayer, or to a decedent by reason of whose death the taxpayer acquired the right to receive the income or gain, or to a trust or estate from which the taxpayer received the income or gain.

(v) The amount of any refund or credit for overpayment of taxes on or measured by income or fees or payments in lieu of income taxes imposed by this state, or any taxing jurisdiction, to the extent included in gross income for federal income tax purposes.

(vi) Accumulation distributions received by a taxpayer as a beneficiary of a trust to the extent that the same are included in federal adjusted gross income.

(vii) Amounts received as annuities under the federal civil service retirement system, from the civil service retirement and disability fund.

(viii) Amounts received by retired railroad employees as a supplemental annuity under the provisions of 45 U.S.C. 228b(a) and 228c(a)(1) *et seq.*

(ix) Amounts received by retired employees of a city and by retired employees of any board of such city as retirement allowances pursuant to K.S.A. 13-14,106, and amendments thereto, or pursuant to any charter ordinance exempting a city from the provisions of K.S.A. 13-14,106, and amendments thereto.

(x) For taxable years beginning after December 31, 1976, the amount of the federal tentative jobs tax credit disallowance under the provisions of 26 U.S.C. 280 C. For taxable years ending after December 31, 1978, the amount of the targeted jobs tax credit and work incentive credit disallowances under 26 U.S.C. 280 C.

(xi) For taxable years beginning after December 31, 1986, dividend income on stock issued by Kansas Venture Capital, Inc.

(xii) For taxable years commencing after December 31, 1984, and prior to January 1, 1990, the amount of any gain realized by a mortgagor resulting from the sale or other disposition of real estate due to the foreclosure of a mortgage upon such real estate or the voluntary conveyance of mortgaged property to the mortgagee, or by a debtor resulting from the release of liability on a contract for the purchase of real estate, to the extent included in the taxpayer's adjusted

gross income for federal income tax purposes. The provisions of this paragraph shall not apply to any gain realized by an investor from any such transaction concerning tax shelters which are required or would have been required to be registered with the federal Internal Revenue Service pursuant to Section 6111 of the Internal Revenue Code, except that, the number of investors under such section shall be determined by treating all members of a family as one investor to the extent they would qualify as class A or class B distributees under K.S.A. 79-1537, and amendments thereto.

(xiii) For taxable years beginning after December 31, 1989, amounts received by retired employees of a board of public utilities as pension and retirement benefits pursuant to K.S.A. 13-1246a and 13-1249 and amendments thereto.

(d) There shall be added to or subtracted from federal adjusted gross income the taxpayer's share, as beneficiary of an estate or trust, of the Kansas fiduciary adjustment determined under K.S.A. 79-32,135, and amendments thereto.

(e) The amount of modifications required to be made under this section by a partner which relates to items of income, gain, loss, deduction or credit of a partnership shall be determined under K.S.A. 79-32,131, and amendments thereto, to the extent that such items affect federal adjusted gross income of the partner.

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

KEYTON E. BARKER and PAULINE BARKER, *et al.*,
Petitioners,
v.
STATE OF KANSAS; KANSAS DEPARTMENT OF REVENUE; SECRETARY OF REVENUE OF THE STATE OF KANSAS; and DIRECTOR OF TAXATION OF THE STATE OF KANSAS,
Respondents.

On Writ of Certiorari to the Supreme Court of Kansas

BRIEF OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES, COUNCIL OF STATE GOVERNMENTS, INTERNATIONAL CITY/COUNTY MANAGEMENT ASSOCIATION, NATIONAL ASSOCIATION OF COUNTIES, NATIONAL GOVERNORS' ASSOCIATION, NATIONAL LEAGUE OF CITIES, AND U.S. CONFERENCE OF MAYORS AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Whether a State violates 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity by taxing military retired pay while exempting state and local government retirement benefits.

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INTEREST OF THE *AMICI CURIAE*

Amici are organizations whose members include state, county, and municipal governments and officials throughout the United States. They and their members have a compelling interest in legal issues that affect state and local governments. Because the question presented in this case concerns the States' taxing

authority, one of the principal attributes of state sovereignty, *amici* submit this brief to assist the Court in the resolution of this case.[1]

STATEMENT

Amici adopt respondents' statement of the case.

SUMMARY OF ARGUMENT

1. The power to tax is one of the principal attributes of state sovereignty. The creation of tax classifications is integral to this power. *See Regan v. Taxation with Representation of Washington*, 461 U.S. 540, 547 (1983). The intergovernmental tax immunity doctrine does not nullify this area of state sovereignty, but establishes a discrete, narrow limitation upon it. As a general matter the United States consents to the taxation of pay or compensation of federal employees; it is only when "the taxation . . . discriminate[s] . . . because of the source of the pay or compensation" that consent is inoperative. *See* 4 U.S.C. § 111; *Davis v. Michigan Department of the Treasury*, 489 U.S. 803, 809 (1989).

The purpose of the intergovernmental tax immunity doctrine is to prevent one government from interfering with the operations of another government. The doctrine does not confer preferential tax treatment on individuals or classes of taxpayers merely because they happen to be federal employees. *See Graves v. New York ex rel. O'Keefe*, 306 U.S. 466, 486 (1939). Petitioners are flatly in error when they argue that whenever a State confers favorable tax treatment on *any* retired state employees,

---

[1] The parties' letters of consent have been filed with the Clerk pursuant to Rule 37.3 of the Court.

the doctrine requires the State to confer identical tax treatment on *every* federal retiree. On the contrary, differential tax treatment of classes of taxpayers is permissible provided "the inconsistent tax treatment is directly related to, and justified by, 'significant differences between the two classes.'" *Davis*, 489 U.S. at 816 (citation omitted).

2. Kansas's differential tax treatment of the benefits of federal military retirees and retired state and local government employees satisfies the requirements of the intergovernmental tax immunity doctrine and Section 111. Military retired pay is properly characterized as reduced current compensation for reduced current services because of the continuing obligations of and restrictions upon retired military personnel. Retired state and local government employees are subject to no comparable obligations or restrictions. Furthermore, all state and local employees must contribute to their retirement; because Congress fully funds military retired pay, no military personnel do so. The fact that military retired pay and state and local pension benefits are, in certain particulars, treated similarly for federal income tax purposes is irrelevant to the validity of the Kansas tax scheme.

ARGUMENT

I. THE INTERGOVERNMENTAL TAX IMMUNITY DOCTRINE DOES NOT NULLIFY THE BROAD POWER OF THE STATES TO CREATE CLASSIFICATIONS IN TAX STATUTES

This case, which challenges income tax classifications drawn by the Kansas legislature, goes to the heart of one of the principal attributes of state sovereignty. "The power of a state to tax [is] basic to its sovereignty." *Bode v. Barrett*, 344 U.S. 583, 585 (1953). As this Court has "often stated[,]. . . . [t]he States have a very wide discretion in the laying of their taxes." *Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522, 526 (1959).

State legislatures accordingly "have especially broad latitude in creating classifications and distinctions in tax statutes." *Regan v. Taxation with Representation of Washington*, 461 U.S. 540, 547 (1983); *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 359 (1973).

> "The broad discretion as to classification possessed by a legislature in the field of taxation has long been recognized. . . . [T]he passage of time has only served to underscore the wisdom of that recognition of the large area of discretion which is needed by a legislature in formulating sound tax policies. Traditionally classification has been a device for fitting tax programs to local needs and usages in order to achieve an equitable distribution of the tax burden. It has, because of this, been pointed out that in taxation, even more than in other fields, legislatures possess the greatest freedom in classification."

Regan, 461 U.S. at 547 (quoting *Madden v. Kentucky*, 309 U.S. 83, 87-88 (1940)).

Consistent with principles of state sovereignty, the intergovernmental tax immunity doctrine, codified in 4 U.S.C. § 111, has a very circumscribed function. It establishes a discrete, narrow limitation on what is otherwise a vital area of state authority. Section 111 expresses the consent of the United States to the taxation of pay or compensation of federal employees, provided only that "the taxation does not discriminate . . . because of the source of the pay or compensation." 4 U.S.C. § 111; *see Davis*, 489 U.S. at 809. A tax "not directly laid on the Federal Government . . . is valid if nondiscriminatory or until Congress declares otherwise." *United States v. County of Fresno*, 429 U.S. 452, 460 (1977) (citation omitted).

The purpose of the doctrine is to prevent one government from using its tax laws to interfere with the operations of another government. *Graves v. New York ex rel. O'Keefe*, 306 U.S. 466, 481 (1939); *Helvering v. Gerhardt*, 304 U.S. 405, 421 (1938). Nondiscrimination is not an end in itself, but is rather a means of "policing" compliance with the doctrine and ensuring that its purposes are served. *See* U.S. Br. 7-8. "The only right that a taxpayer can assert against the state taxing power on the basis of governmental immunity is a 'derivative one.'" *City of Detroit v. Murray Corp.*, 355 U.S. 489, 503 (1958) (opinion of Frankfurter, J.) (quoting *James v. Dravo Contracting Co.*, 302 U.S. 134, 158 (1937)). Any such protections derive from and must be justified by the necessity of protecting the federal government from disparate tax treatment that interferes with its operations.

It is not a purpose of the doctrine, however, to make persons who deal with the United States a

favored class to whom States are *required* by federal law to give preferential tax treatment. Petitioners are in error when they assert (Br. at 13) that whenever a State confers favorable treatment on *any* class of retired state employees, it must confer identical tax treatment on *every* federal retiree. Justice Stevens has explained that "[t]he intergovernmental immunity doctrine simply does not constitute a most favored nation provision requiring the States to accord federal employees and federal contractors the greatest tax benefits that they give any other group subject to their jurisdiction." *Davis*, 489 U.S. at 823 (Stevens, J., dissenting). Neither petitioners nor their *amici* acknowledge this principle or the need to limit the intergovernmental tax immunity doctrine to prevent it from eviscerating the States' sovereign authority to create classifications for tax purposes.

Section 111, which embodies the modern doctrine of intergovernmental immunity, "[i]n effect . . . simply codified the result in *Graves*." *Davis*, 489 U.S. at 812. *Graves*, which held that States may tax federal employees' income, turned upon two important principles that are relevant here. First, the States have a strong sovereignty interest in being able to tax. *Graves*, 306 U.S. at 487. Second, federal employees do not themselves have a constitutionally protected interest in avoiding state taxation; any such protection they receive derives from the doctrine's core concern, *i.e.*, precluding state taxation that interferes with government operations:

> [T]he expansion of the immunity of the one government correspondingly curtails the sovereign power of the other to tax, and where that immunity is invoked by the private citizen it tends

> to operate for his benefit at the expense of the taxing government and without corresponding benefit to the government in whose name the immunity is claimed. . . . [A]s applied to the taxation of salaries of the employees of one government, the purpose of the immunity is not to confer benefits on the employees by relieving them from contributing their share of the financial support of the other government. . . but to prevent undue interference with the one government by imposing on it the tax burdens of the other.

Id. at 483-84 (citation and footnote omitted)

Section 111 was enacted immediately after *Graves* was decided. Congress retained *Graves*'s focus on protecting the federal government rather than granting preferential tax status to federal employees. The purpose of § 111 is "[t]o protect the Federal Government against the unlikely possibility of State and local taxation of compensation of Federal officers and employees which is aimed at, or threatens the efficient operation of, the Federal Government." H.R. Rep. No. 26, 76th Cong., 1st Sess., 5 (1939); S. Rep. No. 112, 76th Cong., 1st Sess., 12 (1939).

Section 111 and the constitutional doctrine it codifies are thus very narrow. Nobody would suggest, for example, that a State could provide its blind residents with a tax exemption only if it provided the same exemption to all federal employees and retirees. *See Davis*, 489 U.S. at 821-22 (Stevens, J., dissenting). Similarly, a State might exempt the pension benefits of disabled state and local firefighters without exempting the retirement benefits of all federal employees. Such an exemption would certainly have a differential impact on federal employees, and by pro-

viding more favorable tax treatment to a class of state and local retirees it could be asserted to discriminate against federal retirees. But the difference in tax treatment plainly would be a result of affirmative state tax policy, rather than discrimination directed at the federal source of compensation.

For these reasons, it is important for the Court to bear in mind in this case, as it did in *Graves*, that too broad a reading of immunity would "impose to an inadmissible extent a restriction on the taxing power which the Constitution has reserved to state governments." *Graves*, 306 U.S. at 487. Applying these principles, *Davis* held that a State discriminates "because of" a federal source of pay or compensation when it favors a class of those who deal with the State over an identical class of those who deal with the federal government. The facts in *Davis* dictated this result. The classes of state and federal government retirees that were subjected to different tax treatment were identical in all ways but one—one class had retired from the state government while the other had retired from the federal government. *See Davis*, 489 U.S. at 805-06. Because there were no "significant differences between the two classes" this inconsistent tax treatment was impermissible source-based discrimination.[2]

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[2] The Court understandably rejected the State's proffered justifications for the inconsistent treatment. First, the State's purpose for providing a tax benefit to retirees—hiring and retaining qualified workers—was irrelevant to demonstrating that there were significant differences between the two classes. *Davis*, 489 U.S. at 816. Second, the State's argument that its benefits were less generous than federal benefits was subject to many exceptions. Hence, the State's justification was not based upon a difference that defined the classes by being true

Here, in contrast to *Davis*, the differences between the classes are, as found by the courts below, substantial. The question presented is whether differential tax treatment is "directly related to and justified by" these differences. *Davis*, 489 U.S. at 816. In making this determination the Court must elaborate upon its analysis in *Davis* in a manner that will both serve the purpose of the intergovernmental tax immunity doctrine and preserve the States' sovereign authority to classify for tax purposes. This is a suitable occasion for doing so since, as detailed in Respondents' Brief (at 4-5 n.3), taxation of military retired pay has been the subject of intensive and prolonged deliberation by the Kansas legislature. A determination that the scheme arrived at by the Kansas legislature is invalid would, *amici* submit, constitute an unwarranted judicial invasion of the State's sovereign authority to draw classifications for tax purposes.

II. DIFFERENTIAL TAX TREATMENT OF FEDERAL MILITARY RETIREES AND RETIRED STATE AND LOCAL GOVERNMENT EMPLOYEES IS DIRECTLY RELATED TO AND JUSTIFIED BY SIGNIFICANT DIFFERENCES BETWEEN THE CLASSES

In contrast to the Michigan tax scheme at issue in *Davis*, the Kansas tax scheme does not tax the retirement benefits of all federal retirees. The retirement benefits of the class of retired federal employees that is similarly situated to Kansas state and local government retirees are exempt from Kansas

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for each and every member of the classes. *Id.* at 816-17; *see Billings v. Illinois*, 188 U.S. 97, 104 (1903) (A tax "classification . . . has relation to [a legislative] purpose [if it] excludes no persons or objects that are affected by the purpose [and] includes all that are.").

income tax. *See* Pet. App. 29a; Kan. Stat. Ann. § 79-32,117(c)(vii) (Supp. 1990) (subtracting from Kansas adjusted gross income "[a]mounts received as annuities under the federal civil service retirement system, from the civil service retirement and disability fund").[3] The retirement benefits received by federal military retirees are not exempt from Kansas income tax, however. This differential treatment of petitioners' class is, as *Davis* requires, directly related to and justified by significant differences between that class and the class of Kansas state and local government retirees.[4]

The court below based its holding on the conclusion that military retired pay, unlike the retirement pay of Kansas state and local government retirees, "is reduced current compensation for reduced current services." Pet. App. 30a. As demonstrated by respondents (Br. at 11-15), this conclusion is fully sup-

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[3] Kansas also exempts benefits paid under the Railroad Retirement Act. *See* Kan. Stat. Ann. § 79-32,117(c)(viii) (Supp. 1990). *See generally* Resp. Br. 24 n.15 (discussing federal retirement benefits exempted from Kansas tax).

[4] Analysis of the validity of the tax is naturally concerned with its actual workings, not its form. As this Court stated in a closely related circumstance,

> in passing on the constitutionality of a state tax we are concerned only with its practical operation, not its definition or the precise form of descriptive words which may be applied to it. Consequently, in determining whether these taxes violate the Government's constitutional immunity we must look through form and behind labels to substance. This is at least as true to uphold a state tax as to strike one down. Due regard for the State's power to tax requires no less.

City of Detroit v. Murray Corp., 355 U.S. at 492-93 (citations and internal quotation omitted).

ported by the continuing obligations of and restrictions upon retired military personnel. See *McCarty v. McCarty*, 453 U.S. 210, 221-22 (1981).[5] It is also squarely in accord with the determinations of this Court and the lower federal courts. *See id.* at 222 ("military retired pay is reduced compensation for reduced current services"); *United States v. Tyler*, 105 U.S. 244, 245 (1882) (military retired pay is "compensation . . . continued at a reduced rate"); *Cornetta v. United States*, 851 F.2d 1372, 1382 (Fed. Cir. 1988) ("Retired pay is reduced pay for reduced current services.") (citing *Hostinsky v. United States*, 292 F.2d 508, 510 (Ct. Cl. 1961)).

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[5] In *McCarty* the Court reaffirmed that:

> "It is impossible to hold that men who are by statute declared to be part of the army, who may wear its uniform, whose names shall be borne upon its register, who may be assigned by their superior officers to specified duties by detail as other officers are, who are subject to the rules and articles of war, and may be tried, not by a jury, as other citizens are, but by a military court-martial, for any breach of those rules, and who may finally be dismissed on such trial from the service in disgrace, are still *not* in the military service."

453 U.S. at 221 n.13 (quoting *United States v. Tyler*, 105 U.S. 244, 246 (1882)).

See also Kahn v. Anderson, 255 U.S. 1, 6-7 (1921) ("it is not open to question . . . that [retired] officers are officers in the military service of the United States"); *Puglisi v. United States*, 564 F.2d 403, 410 (Ct. Cl. 1977), *cert. denied*, 435 U.S. 968 (1978); *Hooper v. United States*, 326 F.2d 982, 987 (Ct. Cl. 1964) (officer's retired pay is "not solely recompense for past services, but a means devised by Congress to assure his availability and preparedness in future contingencies . . . [since retired officer] formed a part of a vital segment of our national defense"), *cert. denied*, 377 U.S. 977 (1964).

In this respect, the differences between retired state and local government employees and retired military personnel could not be more stark. While retired military personnel "may be ordered into active duty" at any time, U.S. Br. 12 & n.20 (citing 10 U.S.C. § 688 (a)); *see also McCarty*, 453 U.S. at 222, there is no remotely similar obligation for any retired Kansas employees. Indeed, the sole category of retired state employees identified by petitioners as subject (under any circumstances) to returning to work—retired members of the judiciary, *see* Pet. Br. 24—do so only on an entirely voluntary basis. *See* Kan. Stat. Ann. § 20-2616 (1988) (retired members of judiciary "may be designated and assigned to perform such judicial service and duties *as such retired justice or judge is willing to undertake*") (emphasis added).

Another significant difference exists in the way Kansas retirement benefits and military retired pay are funded. State and local employees make contributions toward their retirement. Kan. Stat. Ann. §§ 74-4919(1), 74-4921(1) (Supp. 1990). Military personnel do not contribute to their retirement, and are not required to forego present use of any income, because military retired pay is fully funded by annual congressional appropriations. *McCarty*, 453 U.S. at 214; 10 U.S.C. §§ 1461-1467.[6] Military retired pay cannot be characterized as deferred com-

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[6] Petitioners argue that because retirees of the Kansas board of regents and educational institutions under its management may elect to fund their retirement "through salary reductions rather than out-of-pocket contributions," not all Kansas employees must make "contributions" to their retirement. Pet. Br. 25 & n.20. The labels one chooses do not change the fact that *all* Kansas employees must defer income to fund retirement benefits while no federal military personnel do so.

pensation—nothing has been deferred. Military retired pay and state retirement benefits are thus fundamentally different in nature, justifying their differential tax treatment. *Cf. Walters v. City of St. Louis*, 347 U.S. 231, 236 (1954) (state law could classify wage and salary income differently from profits from self-employment or business).

In an attempt to demonstrate that Kansas's treatment of military retired pay is invalid, the petitioners and the United States repeatedly refer to tax treatment of federal retirement benefits not before the Court. *See* Pet. Br. 4, 8, 17, 21, 23, nn.4, 16, 17; U.S. Br. 3-4, 17-19, nn. 27-31. They argue that the determination of whether a state tax scheme discriminates " 'requires an examination of the whole tax structure of the state.' " U.S. Br. 19 n.31 (quoting *Phillips Chemical Co. v. Dumas Indep. School Dist.*, 361 U.S. 376, 383 (1960) (internal quotation and citation omitted)); *see also* Pet. Br. 16.

It is incorrect to read this language from *Phillips* as making immunity turn upon provisions that are not before the Court. In *Phillips* the Court merely found that it could not evaluate "in a vacuum" the constitutionality of state taxation of federal lessees; instead, it had to "focus on the nature of classification" at issue in the case by evaluating both the statute that authorized taxation of federal lessees and the statute that exempted otherwise identical state lessees. 361 U.S. at 383.

Other federal retirement provisions may or may not set up classes that significantly differ from the class of state and local government retirees. Since the issue was never litigated, however, it is impossible to know on this record whether they do or not. Ex-

amining other federal retirement provisions tells the Court nothing about whether the class of military retirees significantly differs from the class of Kansas retirees. This Court should not "formulate a rule of constitutional law broader than is required by the precise facts to which it is to be applied." *Ashwander v. TVA*, 297 U.S. 288, 347 (1936) (Brandeis, J., concurring).

Petitioners place much weight on the fact that military retired pay and state and local pension benefits are, in certain particulars, treated similarly for federal income tax purposes. *See* Pet. Br. 27-29. While petitioners contend that certain cases have stated that military retired pay is taxable as ordinary pension income when received, *see* Pet. Br. 27-28 & n.23, these cases were not deciding whether military retired pay and state and local government pension benefits are given identical treatment for all purposes under the Internal Revenue Code. Instead, they were simply stating that, as is indisputable, both military retired pay and state and local government pensions are currently subject to federal income tax as gross income under the Code since § 61(a) provides that "gross income includes all income from whatever source derived." *Strickland v. Commissioner*, 540 F.2d 1196, 1198 (4th Cir. 1976) (citing 26 U.S.C. § 61(a)). This obviously does not mean that there are no significant differences between the two, or that the two must be treated alike for tax purposes by the States.[7]

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[7] Petitioners suggest that military retired pay is treated by Congress like pension income for purposes of computing deductions for contributions to an IRA. *See* Pet. Br. 29. But since the purpose of an IRA is to enable individuals to set aside

Petitioners, in short, fail to offer any basis for upsetting the sovereign determination of the Kansas legislature to classify military retired pay and state and local government retirement benefits differently for Kansas income tax purposes.[8]

CONCLUSION

The judgment of the Supreme Court of Kansas should be affirmed.

Respectfully submitted,

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February 12, 1992

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some earnings for retirement, *see* S. Rep. No. 383, 93d Cong., 1st Sess. 131 (1973), *reprinted in* 1974 U.S.C.C.A.N. 4890, "to allow an IRA deduction for contributions made with retirement pay would be inconsistent with the purpose of an IRA, regardless of whether [military] retirement pay is 'deferred compensation' or 'reduced compensation for reduced current services.'" Pet. App. 25a.

[8] To say that there is no constitutional immunity here "is not to say that Congress, acting within the proper scope of its power, cannot confer immunity by statute where it does not exist constitutionally." *United States v. City of Detroit*, 355 U.S. 466, 475 (1958).

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

KEYTON E. BARKER and
PAULINE BARKER, *et al.*,
Petitioners,

v.

STATE OF KANSAS, *et al.*,
Respondents.

On Writ of Certiorari to the Supreme Court of Kansas

BRIEF *AMICUS CURIAE* ON BEHALF OF THE RETIRED OFFICERS ASSOCIATION IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Whether the Kansas Income Tax Act violates constitutional or statutory principles of intergovernmental tax immunity, as reecntly applied in *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989), by favoring retired state and local employees over retired members of the United States armed forces.

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IN THE

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OCTOBER TERM, 1991

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On Writ of Certiorari to the Supreme Court of Kansas

BRIEF *AMICUS CURIAE* ON BEHALF OF THE RETIRED OFFICERS ASSOCIATION IN SUPPORT OF PETITIONERS

INTEREST OF THE AMICUS CURIAE

Amicus is The Retired Officers Association ("TROA").[1] TROA is a nonprofit association having its principal place of business in Alexandria, Virginia. Founded in 1929, its membership now includes 376,000 members living throughout the fifty states, Puerto Rico, Guam, the Re-

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[1] Pursuant to Rule 37.3 of the Rules of this Court, the parties have consented to the filing of this brief.

public of the Philippines, and various foreign countries.[2] Its members include past and present, active and reserve, commissioned and warrant officers in the seven Uniformed Services of the United States.[3] TROA is dedicated to maintaining a strong national defense and has been a major advocate on matters involving a broad spectrum of issues related to the preservation of rights and benefits earned through years of dedicated service by both active and retired military personnel.[4]

The State of Kansas and approximately twenty other states have taxed military retirement compensation while exempting from state taxation the retirement benefits of state annuitants. The question presented in this case—whether a state court may engraft an exception to the rule of nondiscrimination under the constitutional doctrine of intergovernmental tax immunity, as codified in 4 U.S.C. § 111, for retired military members—is vitally important to *amicus*. If such an exception is permitted to stand, military retirees and, indeed, military members on active duty throughout the fifty states will be at risk that rights established by Congress may be abridged by the application of conflicting state law standards of review. Moreover, in the specific context of the issue involved in this case, the announcement of the decision below has caused the needless protraction of litigation in other states involving this Court's decision in the case of *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989).[5]

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[2] Set forth in Appendix A is a list of nineteen additional military associations who have joined with TROA in submitting this brief.

[3] The interests of more than 1,000,000 retired members of the Uniformed Services of the United States are represented by the military associations who have joined in filing this brief.

[4] Each of the military associations joining in this brief share this common purpose.

[5] For example, in the wake of this Court's determination in the case of *James B. Beam Distilling Co. v. Georgia*, —— U.S. ——, 111 S. Ct. 2439 (1991), West Virginia has refunded taxes collected in violation of 4 U.S.C. § 111 to civilian federal retirees. However, it continues to litigate its ability to discriminate against military retirees. *See Brown et al. v. Mierke*, C.A. No. 90-C-3341, Circuit Court, Kanawha County, West Virginia.

Amicus has supported the enactment of several measures by Congress which prohibit discrimination of the type upheld by the decision below. Thus, *amicus* has a unique perspective on the question presented by this case as well as a vital interest in its proper resolution.

SUMMARY OF THE ARGUMENT

The decision of the Supreme Court of Kansas presents a question of far-reaching importance: whether a state court may engraft an exception to the rule of nondiscrimination under the constitutional doctrine of intergovernmental tax immunity, as codified in 4 U.S.C. § 111, for retired members of the armed forces?[6] The decision of the Kansas Supreme Court that it was at liberty to use state standards of review to create an exception where Congress has declined to do so conflicts with the decisions of this Court and the will of Congress. Matters implicating the national defense are exclusively the province of Congress. *See* U.S. Const., Art. I, § 8, Cls. 12, 13 and 14. (App. B, *infra*, 2a.). Congress has determined that there are no substantial grounds for distinguishing the tax treatment of military retired pay from other pensions. *See* H.R. Rep. No. 1118, 89th Cong., 1st Sess. 4-5 (1965).[7] Moreover, a reasoned analysis of the Kansas tax scheme leads to the inexorable conclusion that there

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[6] The respondents correctly concede that there is no dispute that military retirees are entitled to receive the protection of 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity. *See* Respondents' Brief In Opposition at 6.

[7] This Court has also recognized that military retired pay is taxable under 26 U.S.C. § 61(a)(11) as pension income when received. *See McCarty v. McCarty*, 453 U.S. 210, 214 n.7 (citing 26 U.S.C. § 61(a)(11); 26 CFR § 1.61-11 (1980)).

are no differences justifying the discriminatory taxation of Kansas military retirees. *Amicus* respectfully submits that this Court should reverse the decision of the court below.

ARGUMENT

A STATE COURT IS NOT AT LIBERTY TO CREATE AN EXCEPTION WHERE CONGRESS HAS DECLINED TO DO SO.

In *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989), this Court construed the "plain language" of 4 U.S.C. § 111 and concluded that the "statute leaves no room for doubt" that federal retirement benefits "are subject to § 111." *Id.* at 808. In resolving the question of the validity of the Michigan Income Tax Act, this Court held that "the relevant inquiry is whether the inconsistent tax treatment is *directly related to*, and *justified* by, 'significant differences between the two classes.'" *Id.* at 816 (emphasis added) (citation omitted). However, in resolving the issue of whether Kansas may discriminate in favor of its own retirees and against military retirees, the Kansas Supreme Court ignored the two pronged *Davis* test and utilized a state standard of review to uphold the Kansas scheme. *See* Petition at 9a.[8]

Neither the lower court's opinion nor the position of the State demonstrates how the differential treatment of military retirees is "based on" the alleged differences between the two classes. *See Phillips Chemical Co. v. Dumas Indep. Sch. Dist.*, 361 U.S. 376, 384 (1960); *Davis*, 489 U.S. at 816-17. The only distinguishing factor set forth in Kansas' exemption provisions is the source of the compensation. There is no evidence of any kind which establishes that the Kansas legislature in-

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[8] In addition, the court below ignored the fact that Kansas' scheme discriminates against all federal retirees except those receiving a civil service annuity. *See* Petition at 16, 28a-29a.

tended to single out military retired pay for discrimination because of any actual or perceived differences from other forms of retirement income. To the contrary, except for the discrimination here in issue, the Kansas legislature has treated military retired pay in a manner similar to other retirement income. *See* K.S.A. § 79-32, 117(a)[9] (1990 Supp.). (App. C, *infra*, 3a).

The court below based its decision on distinctions which are legally insufficient to permit a state to discriminate against military retired pay. However, a state court is "'not at liberty to create an exception where Congress has declined to do so'". *Freytag v. Commissioner*, —— U.S. ——, 111 S. Ct. 2631, 2636 (1991) (citation omitted).

It is within the exclusive province of Congress to make provisions for the retirement of the officers and employees of the United States. Congress has accomplished this through the enactment of a variety of retirement plans, the provisions of which incorporate important policy and personnel decisions made by Congress.[10] *See* U.S. Const., Art. I, § 8, Cl. 18. App. B, *infra*, 2a).

From time to time, these various governmental retirement plans have been modified to reflect the consid-

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[9] The full text of the statute is set forth in the Petition at 47a.

[10] *See, e.g.*, Federal Retirement System Act of 1986, Pub. L. 99-335, 100 Stat. 514 (1986); Public Health Services ["PHS"] retirees paid under 42 U.S.C.A. § 212 (West 1991); National Oceanic and Atmospheric Administration ["NOAA"] retirees paid under 33 U.S.C.A. § 853o (West 1986 and Supp. 1991); Central Intelligence Agency ["CIA"] retirees paid under the Ceneral Intelligence Agency Retirement and Disability Act of 1964 for Certain Persons, Pub. L. 88-643, 78 Stat. 1043 (Oct. 13, 1964), as amended [50 U.S.C.A. § 403 note (West 1991)]; Foreign Service retirees paid from the Foreign Service Retirement and Disability Fund, 22 U.S.C.A. § 4041 et seq. (West 1990 and Supp. 1991); retired Justices and Judges of the United States paid under 28 U.S.C.A. § 371 (West 1968 and Supp. 1991); retired Claims Court judges paid under 28 U.S.C.A. § 178; and retired bankruptcy judges and magistrates paid under 28 U.S.C. § 377 (West Supp. 1991).

ered determinations of Congress that changing personnel needs, unintended inequities, omissions, or intervening court decisions necessitate change to meet specific personnel needs of the United States. *See, e.g.*, Federal Retirement System Act of 1986, P.L. 99-335, 100 Stat. 514 (1986).[11] Whatever differences that may exist between military retired pay and other forms of governmental retirement income, exist because Congress has created them pursuant to the Constitution and in furtherance of the national interest. *See* U.S. Const. Art. I, § 8, Cls. 12, 13, 14 and 18. (App. B, *infra*, 2a.) However, in the exercise of that power, Congress has not consented to the discriminatory state taxation of military retired pay.

The decision below rests on the determination of the Kansas Supreme Court that military retired pay may be taxed differently from other government retirement plans.[12] However, in reaching this conclusion, the court below ignored the manner in which Congress has treated military retired pay.[13] In fact, Congress has never re-

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[11] *See also* Report of the National Advisory Commission on Law Enforcement, April 1990, OCG-90-2 Law Enforcement Pay, which Commission was established by the Anti-Drug Abuse Act of 1988, P.L. 100-690, 102 Stat. 4181 (1988), and charged to provide Congress with a comprehensive study of issues related to the recruitment, retention and morale of career federal law enforcement officers.

[12] The court below and the State purport to rely upon federal cases which have treated military retired pay as "reduced pay for reduced services" for purposes of interpreting and applying certain federal statutes. However, none of those cases has characterized military retired pay as current compensation for income tax purposes and none of those cases even suggest that Congress intended retired pay to be treated as current compensation for purposes of taxation.

[13] Indeed, it apparently was of no moment to the court below that Congress specifically provided in the Public Salary Tax Act of 1939 that the Act was to be construed by reference to the Internal Revenue Code. Sec. 206 of the Act provided that: "[t]he terms used in this Act shall have the same meaning as when used in Chapter 1 of the Internal Revenue Code."

ferred to military retired pay as "reduced pay for reduced service" and has consistently recognized military retired pay as a governmental retirement plan.[14]

Contrary to the decision below, the "relevant inquiry is whether the inconsistent *tax treatment* is directly related to and justified by, 'significant differences between [the favored class (retirees of state and local subdivisions of Kansas) and this disfavored class (military retirees of the United States)].'" *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803, 816 (1989) (emphasis added) (citation omitted). The purpose of the inquiry relates to the ability of a state to discriminate for purposes of taxation against employees of the federal government. Therefore, the focus of the inquiry should be upon the real differences and similarities of the two classes. Here, there are no "*significant differences*" that justify the discriminatory taxation of military retirees.

Congress has, for federal tax purposes, consistently treated military retired pay in the same manner as any other governmental retirement plan. For example, in 1956 Congress amended the Social Security Act ("SSA") and the Federal Insurance Contributions Act ("FICA") to bring military personnel under the contributory system of social security in the United States. Pub. L. No. 84-881, 70 Stat. 870 (1956). *See* 42 U.S.C.A. §§ 409(d), 410(l) and (m) (Supp. 1991); 26 U.S.C.A. §§ 3121(m) and (n) (Supp. 1990).[15] One of the primary purposes of the

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[14] In *McCarty v. McCarty*, 453 U.S. 210, 223 n.16 (1981), this Court observed that the military retired pay of officers is a "personal entitlement" which has characteristics of both deferred and current compensation.

[15] The purpose of this legislation was to "cover military personnel into the contributory Social Security System, thereby supplementing military retirement and survivors benefits." S. Rep. No. 2380, 85th Cong., 2d Sess. 1, reprinted in 1956 U.S. Code Cong. & Admin. News 3976, 3977. For members of the federal military, "[c]ontributions and benefits [are the] same as civilian employ-

Social Security System is to provide benefits upon retirement when employees no longer expect to receive significant amounts of compensation for their services.[16] Congress has funded the Social Security program through FICA taxes imposed on employers and employees based upon specified percentages of "the wages (as defined in section 3121(a)) received by [an individual] with respect to employment." 26 U.S.C.A. § 3101(a) (Supp. 1990). Congress has defined the term "wages" broadly to include "all remuneration for employment" unless otherwise excluded. 26 U.S.C.A. § 3121(a) (Supp. 1990). However, in extending Social Security coverage to military personnel, Congress specified that "basic pay" for active duty service would be included in the term "wages" subject to FICA taxes, but specifically excluded retired pay from the meaning of "wages" subject to FICA taxes. 26 U.S.C.A. § 3121(i)(2) (Supp. 1990).[17]

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ment." House Select Comm. on Survivor Benefits, 84th Cong., 2d Sess., AN ANALYSIS OF PUBLIC LAW 881 (H.R. 7089) 5 (Comm. Print 1956). *See* Survivor Benefit Act: Hearings on H.R. 7089 Before the Senate Comm. on Finance, 84th Cong., 2d Sess. 60 (1956) (statement of Captain David L. Martineau) (regarding employee contributions, "military service personnel . . . would be treated exactly the same as any other citizen who is now covered by social security.").

[16] Participants in the Social Security System become eligible to receive old age benefits at age 62; however, the amount of benefits they otherwise would be entitled to receive are reduced if the participant receives compensation "on account of work" in excess of specified levels. Military retired pay, since it is retirement income, does not reduce social security benefits. *See* 42 U.S.C. § 403(b), (f)(5)(A) and (f)(5)(C)(i).

[17] Similarly, in the context of state income tax withholding, Congress has explicitly recognized and maintained the distinction in treatment between pay for active service and military retired pay. State income taxes may not be withheld from *military retired pay* unless the taxpayer specifically requests that such taxes be withheld. *See* 10 U.S.C. § 1045a. In contrast, current pay for active service is subject to mandatory state tax withholding requirements. *See* 5 U.S.C. § 5517(a).

Similarly, in 1966, Congress amended the Internal Revenue Code to extend to military retirees the same tax treatment extended to civil service retirees and other retirees under qualified pensions for purposes of income, estate and gift taxation of survivor annuities.[18] Pub. L. No. 89-365, 80 Stat. 32 (1966). The legislative history of this Act establishes that Congress determined that:

> [M]embers (or former members) of the uniformed services should be treated essentially the same as retirees under the civil service program and under other qualified pension or annuity plans. Your committee has concluded that there is *no substantial grounds* for distinguishing the *tax treatment* of the plan for the uniformed services from these other plans . . . As a result, your committee has concluded that these uniformed services retirees should be treated in the same manner as pensioners under qualified plans.

H.R. Rep. No. 1118, 89th Congress, 1st Sess. 4-5 (1965) (emphasis added).[19]

In addition, the position of the State adopted by the court below with respect to the "Individual Retirement

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[18] *See, e.g.*, 26 U.S.C. § 122, which conforms the income taxation of military retired pay to the same treatment extended to other governmental retirement and civilian pension plans with respect to survivor annuity benefits. By virtue of its piggyback system of taxation, the tax policy as well as the explicit provisions of section 122 have been adopted as the substantive tax law of Kansas. *See* K.S.A. § 79-32,117(a). (App. C, *infra*, 3a).

[19] Interestingly, by virtue of Kansas' adoption of a piggyback system of state taxation, the Kansas legislature has determined for purposes of its state income tax scheme that "there is *no substantial grounds* for distinguishing the *tax treatment* of the plan for the uniformed services from these other plans." However, the decision in this case leads to the anomalous result that the Kansas legislature, at the same time with respect to the very same subject of taxation, supposedly reached the exactly opposite conclusion that the same plan for the uniformed services was *significantly different*. *See* K.S.A. § 79-32,117(a), Petition at 47a. *Amicus* respectfully submits that such a result is untenable.

Account" ("IRA") is in direct conflict with Congressional enactments and the settled interpretation of the Internal Revenue Service ("IRS"). Congress and the IRS have treated military retired pay as a retirement benefit or deferred compensation for purposes of applying federal income tax provisions which limit the amount a taxpayer may claim as a deduction for contributions to an Individual Retirement Account ("IRA"). The deduction is limited to the lesser of $2,000 or *the amount of the taxpayer's compensation.* 26 U.S.C.A. § 219(a), (b) (Supp. 1991) (emphasis added). The IRS has determined that government retirement benefits under section 414(d), including military retired pay, are not current *compensation* within the meaning of the term as used by Congress in limiting IRA deductions:

> Section 1.219-1(c) of the Income Tax Regulations provides that the term 'compensation' for purposes of sections 219 and 220 of the Code, means wages, salaries, professional fees, or other amount derived from or received from personal services actually rendered . . . . Congress has interpreted this regulation to mean that benefits received under a pension plan or other plan of deferred compensation is not compensation for purposes of sections 219 and 220 of the Code. *See* Staff of the Joint Committee on Taxation, 97th Cong., 2d Sess., General Explanation of the Economic Recovery Tax Act of 1981 (Comm. Print December 29, 1981), page 197 n.1.
>
> This interpretation is consistent with the legislative intent behind the enactment of the tax law relating to IRAs. *The purpose of an IRA is to give employees or self-employed individuals the opportunity to set aside some of their earnings for retirement. See* S. Rep. No. 93-383, 93d Cong., 1st Sess. 131 (1973), 1974-3 C.B. Supp. 210. *To base an IRA deduction upon contributions made with retirement pay would be inconsistent with this purpose.*

Priv. Ltr. Rul. 8227053 (Apr. 9, 1982) (emphasis added). *See also* M. Weinstein, MERTENS LAW OF FEDERAL INCOME TAXATION § 25C.12 at 58 (1988).

The IRS has specifically determined in other letter rulings that the military retirement system is a *retirement plan* under section 414(d) of the Code for the benefit of its employees. See Priv. Ltr. Rul. 8725094 (Mar. 30, 1987); Priv. Ltr. Rul. 8007048 (Nov. 21, 1979). Congress has specifically adopted the interpretation of the IRS by amending section 219(f)(1) of the Code to exclude from the term "compensation" "any amount received as a pension, or annunity [or] as deferred compensation." Technical Corrections Act of 1982, Pub. L. No. 97-448, § 103, 96 Stat. 2365, 2375-76 (1983).[20]

Certainly, if Congress had intended to permit individual states to discriminate against military retirees for purposes of taxation, it would not have acted to insure that military retired pay is afforded the same treatment as all other retirement benefits, including pension benefits paid by state and local subdivisions to their retirees. *See, e.g.*, 26 U.S.C. §§ 3121(a)(5)(E), (i)(2), (m) and (v)(3). Similarly, if there were truly *significant differences* between military retired pay and retirement benefits paid by state and local subdivisions, Congress would have con-

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[20] The Kansas Supreme Court's attempt to distinguish the treatment of military retired pay under the Kansas scheme for purposes of the IRA deduction is unavailing. Prior to the amendment of 219(f)(1) of the Code, the interpretation of the IRS in denying an IRA deduction for military retired pay and other governmental pension payments was premised on the recognition that such payments, including military retired pay, were from governmental plans under 26 U.S.C. § 414(d). Indeed, implicit in Kansas' piggyback system of taxation is recognition of Congress' singular classification of these plans for tax purposes under section 414(d). Accordingly, having adopted Congress' principled tax policy covering governmental retirement plans as part of its own substantive tax law, Kansas cannot credibly urge that military retirement pay is now somehow *significantly different* for purposes of this case.

cluded that there were *substantial grounds* for distinguishing the tax treatment of military retired pay from other retirement plans such as those exempted by Kansas. However, as previously discussed, Congress found to the contrary. *See* H.R. Rep. No. 1118, 89th Cong., 1st Sess. 5 (1965).

Moreover, if military retired pay were *significantly different* from a governmental retirement plan, it certainly would not be subject to a conversion privilege for retired military members who continue their employment with the civil service upon retirement from the military service. However, Congress has specifically recognized that the entitlement to military retired pay is just like the creditable federal service taken into account for the determination of any other retirement benefit and has expressly provided under the authority of 5 U.S.C. § 8347 that, at the option of the retired military member, the entitlement to military retired pay may be converted to a civil service pension.[21] *See* 5 C.F.R. § 831.301.

The decision below also suggests that its holding with respect to military retired pay is supported by the respondents' assertions that: (1) federal military retirees remain members of the armed forces of the United States after they retire from active duty; they are retired from active duty only;[22] (2) federal military retirees are sub-

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[21] In connection with the enactment of the Federal Retirement System Act of 1986, Congress specifically recognized the importance of the portability of retirement benefits upon the recruitment and retention of a motivated career work force as well as permitting midcareer mobility. *See* S. Rep. No. 99-166, 99th Cong., 1st Sess. 4-5 (1985).

[22] But compare, retired members of Kansas' judiciary may "perform such judicial service and duties as such retired justice or judge is willing to undertake." K.S.A. § 20-2616(a). (App. C, *infra*, 3a). They are also authorized to perform marriage ceremonies and serve as "temporary judges" of Kansas district courts. K.S.A. § 23-104a(b)(4); K.S.A. § 20-310b(a) (App. C, *infra*, 3a-4a). However, nowithstanding their continuing status as "judges", their state pensions are exempt from state taxation.

ject to the Uniform Code of Military Justice (UCMJ) and may be court-martialed for offenses committed after retirement;[23] (3) they are subject to restrictions on civilian employment after retirement;[24] and (4) federal military retirees are subject to involuntary recall.[25] *Amicus* respectfully suggests that these assertions are totally irrelevant. Certainly, if this was the basis upon which the discrimination could be justified, the scheme would not discriminate against those persons receiving military retired pay who are not subject to one or more of the so-called alleged differences. For example, former members of the reserves who receive military retired pay under 10 U.S.C. § 1331a while in a civilian status are not subject to any of these so-called differences.[26] Similarly, many civilian retirees of the federal

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[23] However, retired state judges are also subject to discipline for misconduct in office. *See, e.g., In re Hammond*, 224 Kan. 745, 585 P.2d 1066 (1978) (judge who violated Code of Judicial Conduct while in office was subject to public censure for such misconduct following retirement).

[24] Retired state and local firefighters and police officers, whose pensions are tax exempt, completely forfeit their entitlement to any retirement benefits while serving as "a non-elective officer or employee of any municipal or quasi-municipal corporation receiving compensation from public funds." K.S.A. § 13-14a08. (App. C, *infra*, 4a). *See also* K.S.A. § 46-233(a) ("Whenever any individual has, within the preceding two years participated as a state officer or employee in the making of any contract with any person or business, such individual shall not accept employment with such person or business for one year following the termination of employment as a state officer or employee.").

[25] Congress' power to involuntarily call citizens to service is not limited to military retirees. *See* U.S. Const., Art. I, § 8. *See also United States v. Miranda*, 581 S.W.2d 711 (Tex. Civ. App. 1979) ("We are not aware that only persons drawing military retirement pay are available for future contingences. *All* able-bodied citizens are available whether they receive retirement pay or not.") (emphasis added).

[26] *See, e.g.*, 48 Comp. Gen. 699, 1969 WL 3125 (C.G.) (1969) (holding that acquisition of foreign citizenship or foreign military

government are subject to perfectly analogous post-retirement restrictions, including sanctions for criminal misconduct (5 U.S.C. § 8312), restrictions on post-retirement employment (18 U.S.C. § 207) and recall (22 U.S.C. § 3948(a)). However, none of these provisions in any way changes the fact that the pensions paid to retirees of the federal government are deferred compensation for personal services rendered. *See* 59 Cong. Rec. 6300 (April 29, 1920) (statement of Representative Hamil: "pensions are not gratuities . . . they should be looked upon as deferred wages—as payments of wages which were not disbursed at the time they were earned.") Contrary to the assertion of the respondents below, the so-called differences represent nothing more than a considered determination of Congress of what is in the national interest for those who pursue a career of federal service.[27]

The Court below also held that Kansas' discriminatory scheme was justified because of the noncontributory nature of the military retirement system. The Court concluded that the "federal government's method of funding prevents Kansas from taxing a portion of the military retirement benefits before such benefits are received." Petition at 26a. However, Kansas itself does not tax, at

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status does not affect the entitlement of retired pay of a person receiving retired pay under 10 U.S.C. § 1331 since continued service as a reservist is not a condition of the statute in order to receive military retired pay); 28 Comp. Gen. 518, 1949 WL 394 (C.G.) (1949) (holding that termination of reserve status prior to satisfying the age requirement for receipt of retired pay does not disqualify a person from receiving retired pay since a person who otherwise qualifies need not be a member of a reserve component in order to receive retired pay).

[27] Indeed, contrary to the decision below, a reasoned analysis of Kansas' own legislative scheme establishes that a significant part of the favored class of state retirees is subject to restrictions similar in kind and degree to the restrictions which purportedly justify the discrimination imposed upon military retirees. *See* footnotes 22-25, *supra*.

any time, the contributions that state or local governmental *employers* make to fund a state employee's pension. Petition at 26a.[28] As this Court recognized in *Davis*, a "tax exemption truly intended to account for differences in [the funding of] retirement benefits would not discriminate on the basis of the source of those benefits, as [Kansas'] statute does; rather, it would discriminate on the basis of the amount of benefits received by individual retirees [which were previously taxed]." *Davis*, 489 U.S. at 817. Accordingly, for purposes of 4 U.S.C. § 111, it is obvious that Kansas' proffered rationale fails "because an evenhanded application of the rationale would have resulted in inclusion of some [state retirees] in the disfavored class." *Id.*[29]

Under the doctrine of intergovernmental tax immunity, "the State [must] treat those who deal with the Government as well as it treats those with whom it deals itself." *Phillips Chemical Co. v. Dumas Indep. Sch. Dist.*, 361 U.S. 376, 385 (1960). Consistent with this doctrine, 4 U.S.C. § 111 prohibits the discriminatory state taxation of "salaries, retirement benefits, and other forms of compensation . . . on account of the source of the compensation." *Davis*, 489 U.S. at 810. Nothing in the doctrine of intergovernmental tax immunity or the statute differentiates between military and other federal employees.

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[28] Moreover, contrary to the suggestion in the opinion below, some *employee* contributions are never taxed. *See, e.g.*, K.S.A. §§ 74-4923(b) and 74-4925(1)(a) and (4) (Supp. 1990). These provisions are reprinted in the Petition at 51a-53a.

[29] It is ironic, indeed, that the court below justified Kansas' scheme on this basis when the Internal Revenue Service has consistently adhered to the doctrine of intergovernmental tax immuity and the provisions of the Public Tax Act of 1939 by recognizing that the part of *current* pension payments received by state and local retirees, which is attributable to *employer* contributions for years prior to 1939, is exempt from the federal income tax in accordance with the requirements of the Act. *See* Rev. Rul. 56-82, 1956-1 C.B. 59; Rev. Rul. 57-75, 1957-1 C.B. 28.

As this Court recognized in *Davis*, "[t]he danger that a State is engaging in impermissible discrimination against the Federal Government is greatest when the State acts to benefit itself and those in privity with it." *Id.* at 815 n.4. In the instant case, the Kansas Supreme Court acted impermissibly when it chose to utilize a state standard of review to measure Kansas' discriminatory scheme.

CONCLUSION

Contrary to the decisions of this Court in *Phillips* and *Davis*, the Court below utilized a state standard of review in creating a distinction without a difference so as to justify a result which violates the express will of Congress. *Amicus* respectfully urges that this Court reverse the decision below.

Respectfully submitted,

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January 10, 1992

APPENDICES

APPENDIX A

The military associations listed below have joined with TROA in the filing of this brief:

Air Force Association (AFA)

Association of Military Surgeons of the United States (AMSUS)

Chief Warrant and Warrant Officers Association, U.S Coast Guard (CW&WOA)

Commissioned Officers Association of the U.S. Public Health Service, Inc. (COA)

Fleet Reserve Association (FRA)

Marine Corps League (MCL)

Marine Corps Reserve Officers Association (MCROA)

National Guard Association of the United States (NGAUS)

National Military Family Association (NMFA)

Naval Reserve Association (NRA)

Navy League of the United States (NLUS)

Reserve Officers Association (ROA)

Society of Medical Consultants to the Armed Forces (SMCAF)

The Jewish War Veterans of the United States of America (JWV)

The Military Chaplains Associations (MCA)

The Retired Enlisted Association (TREA)

U.S. Army Warrant Officers Association (USAWOA)

U.S. Coast Guard Enlisted Association (CGEA)

U.S. Coast Guard Chief Petty Officers Association (CPOA)

APPENDIX B

Article I, Sec. 8 of the United States Constitution provides in relevant part:

> The Congress shall have power
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> * * * *
>
> To raise and support armies, but no appropriation of money to that use shall be for a longer term than two years;
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> To provide and maintain a navy;
>
> To make rules for the government and regulation of the land and naval forces;
>
> * * * *
>
> To make all laws which shall be necessary and proper for carrying into execution the foregoing powers, and all other powers vested by this constitution in the government of the United States, or in any department or officer thereof.

APPENDIX C

Excerpts of Relevant Kansas Statutes

Kan. Stat. Ann. § 79-32,117(a) (Supp. 1990) provides:

> Kansas adjusted gross income of an individual.
>
> (a) The Kansas adjusted gross income of an individual means such individual's federal adjusted gross income for the taxable year, with the modifications specified in this section.

Kan. Stat. Ann. § 20-2616 provides:

> Designation and assignment of retired justices and judges to perform judicial service and duties; revocation; powers; compensation and expense allowances, limitation.
>
> (a) Any retired justice of the supreme court, retired judge of the court of appeals, retired district judge or retired associate district judge may be designated and assigned to perform such judicial service and duties as such retired justice or judge is willing to undertake. . . .

Kan. Stat. Ann. § 23-104a provides:

> Solemnizing marriage; persons authorized to officiate.
>
> (a) Marriage may be validly solemnized and contracted in this state, after a license has been issued for the marriage, in the following manner: By the mutual declarations of the two parties to be joined in marriage, made before an authorized officiating person and in the presence of at least two competent witnesses over 18 years of age, other than the officiating person, that they take each other as husband and wife.
>
> (b) The following are authorized to be officiating persons:

* * * *

(4) any retired judge or justice of a court of record.

Kan. Stat. Anh. § 20-310b provides:

Temporary judges.

(a) Upon stipulation of the parties to an action, the court may order the action to be heard and determined by a temporary judge who is a retired justice of the supreme court, retired judge of the court of appeals or retired judge of the district court. Such temporary judge shall be sworn and empowered to act as judge in the action until its final determination.

Kan. Stat. Ann. § 13-14a08 provides:

Payments upon retirement or discharge from police or fire department.

Any officer or member of any such police department or fire department who has served twenty-two (22) years or more on such department and has reached the age of fifty (50) years may make application to be retired, and if such application is made the respective board of trustees shall retire such officer or member and shall pay such officer or member monthly payments in amounts equal to fifty percent (50%) of such officer or member's monthly salary at the date of retirement, or if such officer or member has been discharged from such department by reason of disabiilty, or if such officer or member voluntarily terminated employment with such department, or if such officer or member has been discharged for any reason, except conviction of a felony, after such officer or member has served twenty-two (22) or more years in such department, the respective board of trustees shall order and direct that said person, upon attaining the age of fifty (50) years, be paid monthly payments in amounts equal to fifty percent (50%) of the monthly salary of such officer or member at the

date of discharge. No person who retires after the effective date of this act shall be paid any benefits under the provisions of this section while such person is a nonelective officer or employee of any municipal or quasi-municipal corporation receiving compensation from public funds.

Supreme Court, U.S.
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No. 91-611

In The

Supreme Court of the United States

October Term, 1991

KEYTON BARKER AND PAULINE BARKER, *et al.*,

Petitioners,

v.

STATE OF KANSAS; KANSAS DEPARTMENT OF REVENUE; SECRETARY OF REVENUE OF THE STATE OF KANSAS; AND DIRECTOR OF TAXATION OF THE STATE OF KANSAS,

Respondents.

On Writ Of Certiorari to the Supreme Court Of Kansas

BRIEF OF ARIZONA, ARKANSAS, GEORGIA, IOWA, MONTANA, OKLAHOMA, UTAH, VIRGINIA AND WISCONSIN AS AMICI CURIAE IN SUPPORT OF RESPONDENTS

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INTEREST OF AMICI CURIAE

This brief in support of Kansas is submitted on behalf of Arizona, Arkansas, Georgia, Iowa, Montana, Oklahoma, Utah, Virginia and Wisconsin pursuant to United States Supreme Court Rule 37.

The question presented in this case was generated by this Court's decision in *Davis v. Michigan Department of the Treasury*, 489 U.S. 803 (1989) ("*Davis*"), relating to the taxation of federal, state and local government retirement benefits. The effect of the Court's decision in *Davis* was not only to undo certain aspects of the income tax structure in at least twenty-three states but also to raise the issue of under what circumstances these states must refund taxes previously imposed.

This case is thus an example of how a single United States Supreme Court decision declaring a state tax unconstitutional can profoundly affect the tax structure in numerous other states and impose an unanticipated liability on such states. For these reasons, amici curiae have a direct and abiding interest in the present case.

SUMMARY OF ARGUMENT

Amici curiae urge this Court to affirm the ruling of the court below that 4 U.S.C. § 111 as interpreted in *Davis* does not invalidate Kansas' differential tax treatment of the pay of federal military retirees and the retirement benefits of state and local government retirees. Should this Court not affirm the ruling of the court below, amici curiae urge this Court to expressly reserve the question of

the retroactivity of its decision until the issue can be fully briefed and argued. The retroactivity question presents an issue of particular complexity based on shifting Supreme Court plurality opinions, and its resolution could have a massive financial impact on parties not present or represented.

ARGUMENT

I. STATES MAY, CONSISTENT WITH *DAVIS*, TREAT MILITARY RETIREMENT PAY DIFFERENTLY FROM STATE AND LOCAL GOVERNMENT RETIREMENT BENEFITS.

Amici curiae adopt and fully support the argument of Respondents that the Court's *Davis* decision should not be expanded to invalidate the differential state taxation between federal military retirees and the retirement benefits of civil state and local government retirees. As shown in Respondents' brief, significant differences in these two categories of taxpayers justify such treatment under the test set forth in *Davis* for application of 4 U.S.C. § 111. Amici curiae therefore urge the Court to affirm the ruling below. Should the Court decide that a state's tax system may not, consistent with *Davis*, include such a differential tax treatment, amici curiae ask, in that case, that the Court expressly reserve the question of the retroactivity of such a holding.

II. CERTIORARI WAS NOT GRANTED ON THE ISSUE OF RETROACTIVITY, AND THE COURT SHOULD EXPRESSLY RESERVE THAT ISSUE.

The sole question decided by the courts below and presented to this Court in the Petition for a Writ of Certiorari is "whether the Kansas Income Tax Act violates constitutional or statutory principles of intergovernmental tax immunity, as recently applied in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989). . . . " Petition for Writ of Certiorari at i. Because the courts below held that the differential tax treatment under the Kansas Income Tax Act did not violate the doctrine of intergovernmental tax immunity as applied in *Davis* and thus granted summary judgment to defendants, they did not address the question of refunds or the retroactivity of *Davis*.

While the retroactivity issue, therefore, is not presented in this case, this Court in *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991) ("*Beam*"), made two statements that are of significant concern to amici curiae in the context of this case. First, Justice Souter in his opinion stated that the remand of *Bacchus Imports, Ltd v. Dias*, 468 U.S. 263 (1984), for consideration of a defense raised by the state on the question of refunds "could be fairly read" as an *implicit* ruling by the Court that *Bacchus* applied retroactively. 111 S. Ct. at 2445. To avoid a similar disposition in this case, amici curiae urge that any remand order issued by this Court expressly state that the Court is not ruling on the question of retroactivity.

The second statement in *Beam* of concern to amici curiae is the statement by Justice Souter that "[b]ecause the *Bacchus* opinion did not reserve the question whether

its holding should be applied to the parties before it, . . . it is properly understood to have followed the normal rule of retroactive application in civil cases." 111 S. Ct. at 2445. To the extent that this statement indicates that any decision of the Court is retroactive unless the Court expressly reserves the question, amici curiae urge this Court expressly to reserve the question of the retroactivity of its decision in this case. The Court may effectively reserve the question either by so stating in any remand order or by retaining jurisdiction and setting the retroactivity issue for additional briefing and argument. Reservation of the retroactivity issue is appropriate in this case because of the vast reach of the *Davis* decision and the massive financial impact that such a ruling could have on the affected states.

On March 28, 1989, the Court decided *Davis*, holding that states may not, consistent with the intergovernmental tax immunity doctrine embodied in 4 U.S.C. § 111, provide a state income tax benefit to state and local government retirees without providing the same benefit to federal government retirees. At the time of the *Davis* decision, at least twenty-three states had statutes similar to the Michigan statute invalidated in *Davis*. Many of the statutes had been in effect and unchallenged for nearly half a century. *See, e.g.*, Ch. 325, 1942 Va. Acts 500.

The *Davis* decision had two significant impacts on these states. First, the states affected by this unanticipated change in the federal law were put to the task of analyzing their tax systems and enacting amendments to bring their systems into compliance with *Davis*, often resulting in a loss of anticipated and already budgeted

revenues. Second, the *Davis* decision generated litigation in at least twenty-three states. This litigation presented two issues: (1) whether the states' pre-*Davis* or post-*Davis* tax systems were or are consistent with *Davis;* and (2) if not consistent, whether states may fulfill their constitutional obligation created by *Davis* by changing their tax systems for the future or whether states must in addition give remedial relief, such as refunds, for taxes imposed prior to *Davis.*[1] The latter issue in much of the state litigation may depend, to a greater or lesser extent, on whether *Davis* is retroactive.

Amici curiae submit that this issue should not be decided without the parties before the Court fully briefing and presenting oral argument on that issue. The parties in the instant case have not sought certiorari on this issue nor briefed it to the Court. Reserving determination on the retroactivity issue is especially appropriate in this case for several reasons. The retroactivity of the Court's decision could have a massive financial impact on parties not present or represented. Refund claims against states affected by *Davis* are estimated to

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[1] In some states, taxpayers also brought suit pursuant to 42 U.S.C. § 1983, seeking to impose personal liability on state officials and to collect attorney's fees. In the only federal case to reach this issue, Judge J. Harvey Wilkinson, writing for the Fourth Circuit Court of Appeals, held that the state revenue official was entitled to qualified immunity. *Swanson v. Powers,* 937 F.2d 965 (4th Cir. 1991), *cert. denied,* 60 U.S.L.W. 3478 (U.S. Jan. 13, 1992) (to hold official liable would create miscarriage of justice because law not clearly established prior to *Davis*).

exceed $2.2 billion.[2] Moreover, as discussed below, the retroactivity issue is one of particular complexity based on recent Supreme Court precedent. *See Beam, supra; American Trucking Associations, Inc. v. Smith*, 110 S. Ct. 2323 (1990) (*"ATA"*); *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, 110 S. Ct. 2238 (1990) (*"McKesson"*).

III. THE RETROACTIVITY ISSUE IS TOO COMPLEX AND FAR-REACHING TO BE DECIDED WITHOUT FULL BRIEFING AND ARGUMENT.

Because Michigan stipulated to the payment of a refund to the taxpayer in *Davis*, the question of the retroactivity of *Davis* was not presented in that case. *Davis*, 489 U.S. at 817. As state courts were called upon to decide the question of refunds under their state laws following *Davis*, some states determined that state law mandated refunds irrespective of the retroactivity or prospectivity of *Davis*. *See, e.g., Hackman v. Director of Revenue*, 771 S.W.2d 77 (Mo. 1989), *cert. denied*, 110 S. Ct. 718 (1990). Other state courts determined that taxpayers were not entitled to refunds on independent state law grounds. *See, e.g., Harper v. Virginia Department of Taxation*, 241 Va. 232, 401 S.E.2d 868, *vacated and remanded*, 59 U.S.L.W. 3864 (U.S. June 25, 1991), *aff'd*, 243 Va. ___, 410 S.E.2d 629 (1991), *petition for cert. filed*, 60 U.S.L.W. 3406 (U.S. Nov. 15, 1991) (No. 91-794).

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[2] *See* W. Hellerstein, *Preliminary Reflections on McKesson and American Trucking Associations*, 48 Tax Notes No. 3, 325, 326 (July 16, 1990).

In determining the application of federal law to a state's obligation under state law to refund taxes imposed prior to *Davis*, state courts looked to this Court's 1990 pronouncements in *ATA* and *McKesson* for guidance. Most recently, state courts have looked to the Court's 1991 decision in *Beam*. A review of *Beam* illustrates the complexity of the retroactivity issue now being litigated in numerous state courts.[3]

Justice Souter in *Beam*, like the four dissenting Justices in *ATA*, distinguishes between retroactivity as a choice of law principle and retroactivity as a remedial principle. 111 S. Ct. at 2443. Justice Souter explains that the choice of law aspect of retroactivity presents a federal question where the rule at issue derives from federal law. However, in tax cases such as the present one, "the remedial inquiry is one governed by state law, at least where the case originates in state court." *Id.*

It appears from this statement that nothing in *Beam* precludes the denial of refunds under state law in a case such as the present one, regardless of this Court's decision on the substantive issue presented. This conclusion is supported by Justice Souter's statement on the narrow reach of the *Beam* decision:

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[3] Five opinions were written in *Beam*, none of which commanded a majority of the Court. The lead opinion, written by Justice Souter, was joined by only Justice Stevens. Justice White wrote a separate concurrence. Justices Blackmun, Marshall and Scalia – in two separate opinions, each joined by the three of them – also concurred separately. And there was a dissent written by Justice O'Connor, joined by Chief Justice Rehnquist and Justice Kennedy.

> The grounds for our decision today are narrow. They are confined entirely to an issue of choice of law: when the Court has applied a rule of law to the litigants in one case it must do so with respect to all others not barred by procedural requirements or res judicata. We do not speculate as to the bounds or propriety of pure prospectivity.
>
> Nor do we speculate about the remedy that may be appropriate in this case; remedial issues were neither considered below nor argued to this Court, save for an effort by petitioner to buttress its claim by reference to our decision last Term in *McKesson*. As we have observed repeatedly, federal "issues of remedy . . . may well be intertwined with or their consideration obviated by, issues of state law." *Bacchus*, 468 U.S., at 277, 104 S.Ct., at 3058. Nothing we say here deprives respondent of his opportunity to raise procedural bars to recovery under state law or demonstrate reliance interest entitled to consideration in determining the nature of the remedy that must be provided, a matter with which *McKesson* did not deal.

111 S. Ct. at 2448.

Following his distinction between retroactivity as a choice of law principle and as a remedial principle, Justice Souter also distinguishes between selective prospectivity and pure prospectivity, citing *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971) (*"Chevron Oil"*), as an example of pure prospectivity. 111 S. Ct. at 2443. In selective prospectivity, the Court may apply a rule of law to the litigants in one case but not to others whose facts arose

before the announcement of the new decision. While Justice Souter rejects selective prospectivity as a choice of law principle, he does not "speculate as to the bounds or propriety of pure prospectivity." *Id.* at 2448.

The Court in *Davis* did not apply the rule there announced retroactively since Michigan had removed the issue by conceding to the payment of refunds. Accordingly, it appears that *Davis* represents a proper case for the application of pure prospectivity.

It also appears from *Beam* that *Chevron Oil* remains the proper test for the determination of prospectivity. The three dissenting Justices in *Beam*, Chief Justice Rehnquist and Justices O'Connor and Kennedy, clearly adopt this standard. 111 S. Ct. at 2451 (*Chevron Oil* describes Court's long-established procedure for determining whether new rule applies to conduct occurring before decision). Justice White, in his opinion concurring in the result in *Beam*, reaffirms his view, as expressed by Justice O'Connor for the plurality in *ATA*, that in the proper case a new rule of law will not apply retroactively based on a *Chevron Oil* analysis. 111 S. Ct. at 2449. Finally, while Justice Souter does not "speculate" as to the "bounds" of pure prospectivity, he does not suggest that he would overrule *Chevron Oil* but only that he would not apply it "to the end" of selective prospectivity. 111 S. Ct. at 2445.

In summary, this Court's decision in *Beam* raises four issues for the instant case: (1) whether *Davis* is a proper case for the application of pure prospectivity; (2) if so, whether *Chevron Oil* applies to determine the prospectivity of *Davis;* (3) if so, whether *Davis* satisfies the *Chevron Oil* standard; and (4) if the answer to all or any of the

preceding questions is no, whether this Court's choice of law conclusion precludes an ultimate denial of remedial relief that is based on state law grounds.

These issues are complex, interrelated and far-reaching. Amici curiae urge this Court to refrain from deciding these issues until they can be fully briefed and argued.

CONCLUSION

The Court should affirm the ruling of the court below. If the Court does not so affirm, it should not decide whether its decision is retroactive until the question is fully briefed and argued to the Court.

Respectfully submitted,

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